Domtar Inc. 2001 Annual Report



# Highlights

(In millions of Canadian dollars, unless otherwise noted)

| | 2001 US$(1) | 2001 | 2000 | 1999 | 1998 | 1997 |
|---|---|---|---|---|---|---|
| **Operating results** | | | | | | |
| Net sales | 2,748 | 4,377 | 3,598 | 3,067 | 2,348 | 1,938 |
| EBITDA | 381 | 607 | 715 | 608 | 384 | 200 |
| Operating profit | 196 | 313 | 476 | 379 | 200 | 56 |
| Net earnings | 95 | 152 | 275 | 163 | 74 | 25 |
| Net earnings per common share | 0.49 | 0.78 | 1.49 | 0.87 | 0.44 | 0.15 |
| Weighted average number of common shares outstanding (millions) | 191.2 | 191.2 | 182.9 | 183.9 | 163.4 | 150.4 |
| **Balance sheet data** | | | | | | |
| Total assets | 4,459 | 7,102 | 4,267 | 4,019 | 4,030 | 2,962 |
| Net debt-to-total-capitalization (%)(2) | 54% | 54% | 35% | 37% | 41% | 32% |
| Year-end book value per common share | 6.70 | 10.66 | 9.87 | 9.44 | 8.73 | 8.03 |
| **Cash flows** | | | | | | |
| Cash flows provided from operating activities | 457 | 727 | 587 | 326 | 248 | 125 |
| Net additions to property, plant and equipment | (179) | (286) | (242) | (201) | (205) | (130) |
| Free cash flow | 278 | 441 | 345 | 125 | 43 | (5) |
| Free cash flow per common share | 1.45 | 2.31 | 1.89 | 0.68 | 0.26 | (0.03) |
| **Value creation** | | | | | | |
| Return on common shareholders' equity (ROE)(3) | 8% | 8% | 16% | 10% | 5% | 1% |

(1) For the convenience of the reader, the 2001 "Highlights" have been translated into U.S. dollars at the year-end rate of CAN$1.5926 = US$1.00.
(2) Ratio of long-term debt and bank indebtedness (net of cash and short-term investments) to total capitalization.
(3) The 1997 figures exclude a non-recurring $17 million after-tax gain realized on the contribution of Domtar's packaging net assets to Norampac.

# You'll find it everywhere.

Touching our lives in more ways than you ever imagined. The "new" Domtar's purpose is to create greater opportunities for you every day. With more and better products, Domtar customers, investors and employees grow stronger. And like us, paper gains in value with each innovative application we find. Don't ask if there's a future for paper. Just look around you. The answer is yes. It's everywhere. And it's Domtar.

# Meeting our commitments

## Enhance customer loyalty

Reorganization of management responsibilities, further strengthening customer-focused approach

Creation of a single sales team for pulp and paper and consolidation of customer relations activities at 2 service centers (Atlanta and Montreal)

Partnership with Heidelberg Canada to distribute graphic supplies through the Domtar Paper Merchants Group network

Launch of Domtar Titanium™–new high-end opaque-plus printing paper

48-hour delivery for stock paper items

Launch of PowerJoIst™ a new engineered wood product

Industry leading 95% on-time shipment of wood products

Lumber sales conducted under long-term contracts reached 35%

## Double our size

Acquisition of four paper mills in the U.S.

Third largest manufacturer of uncoated freesheet in North America

Most important manufacturer of specialty papers in North America

More depth and range in paper product offerings

Doubled paper manufacturing capacity

12,500 employees in the U.S. and Canada

Additional primary and converting capacity within Norampac

## Increase our productivity

Launch of US$65 million synergies program

Commit to deliver CAN$100 million Quality and Profitability Program by end of 2003

Participation of close to 7,500 employees in Management by Commitment Training Program

Participation of more than 2,000 employees in 149 Kaizen Continuous Improvement Workshops

Implementation of Enterprise Resource Planning system in Wood segment

Installation of new small log curve sawing equipment

ISO 9002 certification of Val d'Or and Ste-Marie de Beauce sawmills

New labor agreements at Ashdown and Woodland paper mills and at Nairn Center and Elk Lake sawmills

## Continue our good citizenship

ISO 14001 certification of management practices on 22 million acres of forest-land managed directly by Domtar

Participation in the development of Forest Stewardship Council standards for the Canadian boreal forest

Creation of Internet-based application allowing public access and comment on forest activities

Completion of co-generation plant at the Windsor mill

Creation, directly or indirectly, of approximately 300 jobs for First Nations

Contributions of $1.1 million through Domtar's Community Investment Program

## Maintain our financial return edge

Increased sales

Return on shareholders' equity higher-than-industry-average

Total capital expenditures within annual depreciation

Increased free cash flow

Significant reduction of net debt-to-total-capitalization ratio after acquisition

Domtar stock outperforms all major stock indices

Inclusion in the Dow Jones Sustainability Group Index for third consecutive year

# Papers 82%[(1)]

Pulp and Paper Sales, Marketing and Customer Relations Group

- Partner with some 150 independent merchants serving 350 locations in the U.S. and Canada

Canadian Pulp and Paper Manufacturing Group

U.S. Pulp and Paper Manufacturing Group

- 12 pulp and paper mills (5 in the U.S. and 7 in Canada)
- Annual paper manufacturing capacity: 2.8 million tons
- Annual net pulp position: 575,000 tonnes

Paper Merchants Group

- Ris Paper Company, Inc. (U.S.)
- Buntin-Reid/JBR la maison du papier/ The Paper House (Canada)

Approximately 9,200 employees

# Wood 8%[(1)]

Forest Resources Group

- Management of 36.4 million acres of forest-land in Canada and the U.S.

Wood Products Group

- 16 sawmills, including 2 re-manufacturing facilities in Canada
- Annual manufacturing capacity: 1.2 billion board feet
- Joint ventures:
  - Anthony-Domtar Inc. (I-Joist)
  - Nabakatuk sawmill (with Cree First Nation of Waswanipi)

Approximately 3,300 employees

# Packaging 10%[(1)]

Norampac Inc. (50-50 joint venture with Cascades Inc.; independently managed)

8 containerboard mills and 25 converting plants in Canada, the United States, Mexico and France

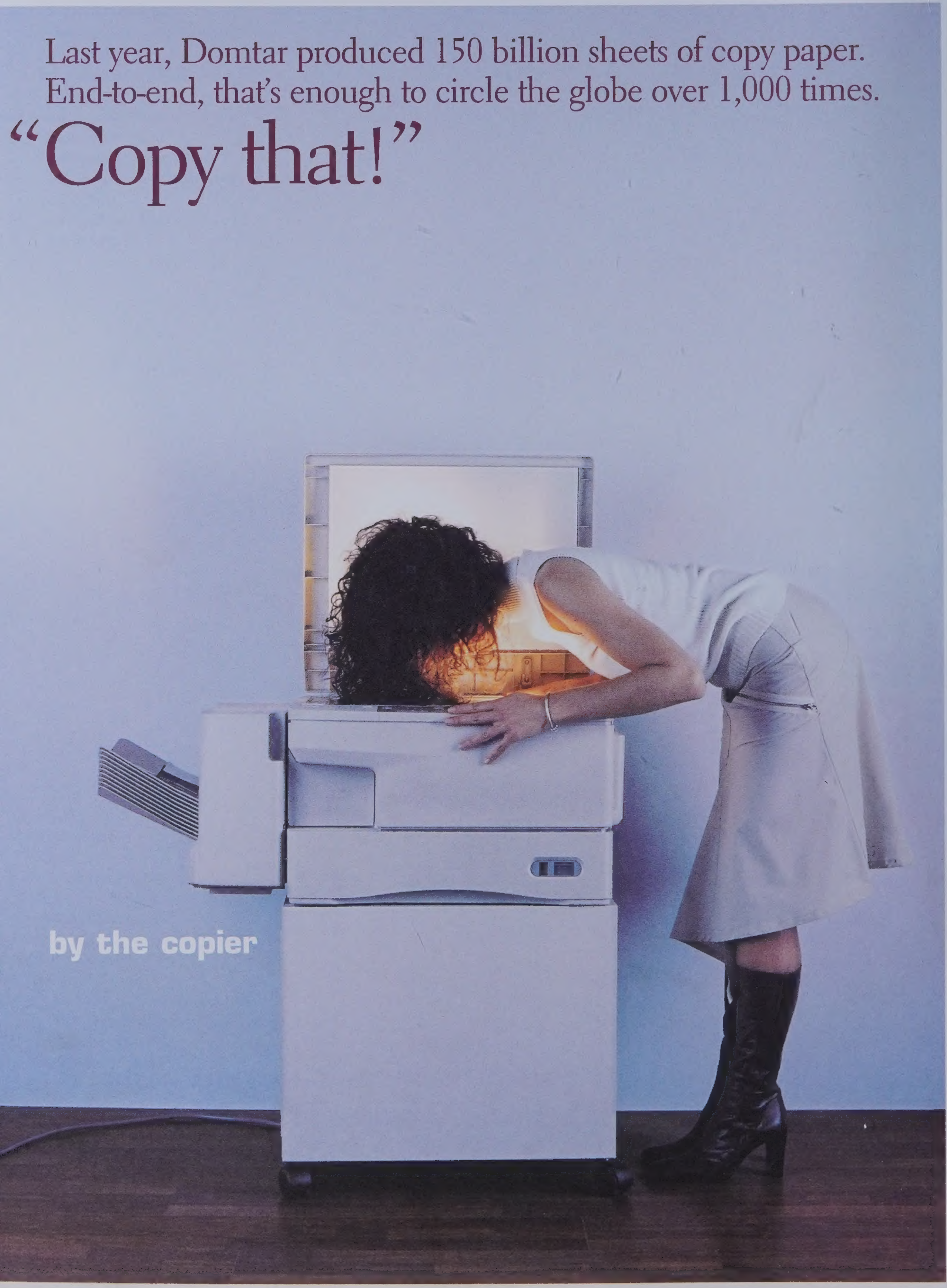
Annual manufacturing capacity of containerboard: 1.6 million tonnes

Annual manufacturing capacity of corrugated containers: 10 billion square feet

(1) Net sales allocation of segment based on 4th quarter 2001 figures.

# Your life, our products

| Customers | Products | Applications |
|---|---|---|
| **Business papers**<br>Business offices<br>Homes | Copy<br>Premium imaging | Photocopies<br>Office documents<br>Presentations |
| **Printing and publishing papers**<br>Commercial printers and publishers | Offset<br>Business converting<br>Lightweight uncoated<br>Opaques<br>Text and cover<br>Lightweight coated<br>Premium coated<br>Regular coated | Pamphlets<br>Brochures<br>Direct mail<br>Commercial printing<br>Forms and envelopes<br>Stationery<br>Annual reports<br>Books<br>Catalogues<br>Magazines |
| **Technical and specialty papers**<br>Converters and makers of end products | Flexible packaging<br>Abrasive papers<br>Decorative papers<br>Imaging papers<br>Label papers<br>Medical disposables | Food and candy wrappings<br>Surgical gowns<br>Repositionable note pads<br>Security check papers<br>Wallpapers |
| **Value-added and dimensional lumber**<br>Home improvement centers<br>Wholesalers and distributors | Premium, J-Grade, Decking, MSR, I-Joist<br>Dimensional lumber<br>Studs | Building and remodeling<br>Residential construction |
| **Wood components**<br>Re-manufacturers of wood products | Wood components | Re-manufactured into bed frames, shelving, door and window components, etc |
| **Packaging**<br>Makers of boxes<br>End users of containerboard boxes | Custom made boxes | Packaging of very small to very large objects |


Last year, Domtar produced 150 billion sheets of copy paper.
End-to-end, that's enough to circle the globe over 1,000 times.
"Copy that!"
by the copier


# 70 billion tactile messages were written on our paper in 2001. "Get the message?"

* Canary Yellow note color is a trademark of 3M.


Our imaging papers helped people print and share more than 1 billion moments with family and friends everywhere.
"Oh! She's so adorable!"
with your personal printer


Most personal checks in North America are now made using our security papers. "How 'bout that!
It was in the mail!"
in the mailbox

Enough specialty paper to publish 18 million books was manufactured and sold by Domtar last year.
"I read that somewhere."
on shelves everywhere
Tuesdays With Morrie
Mitch Albom

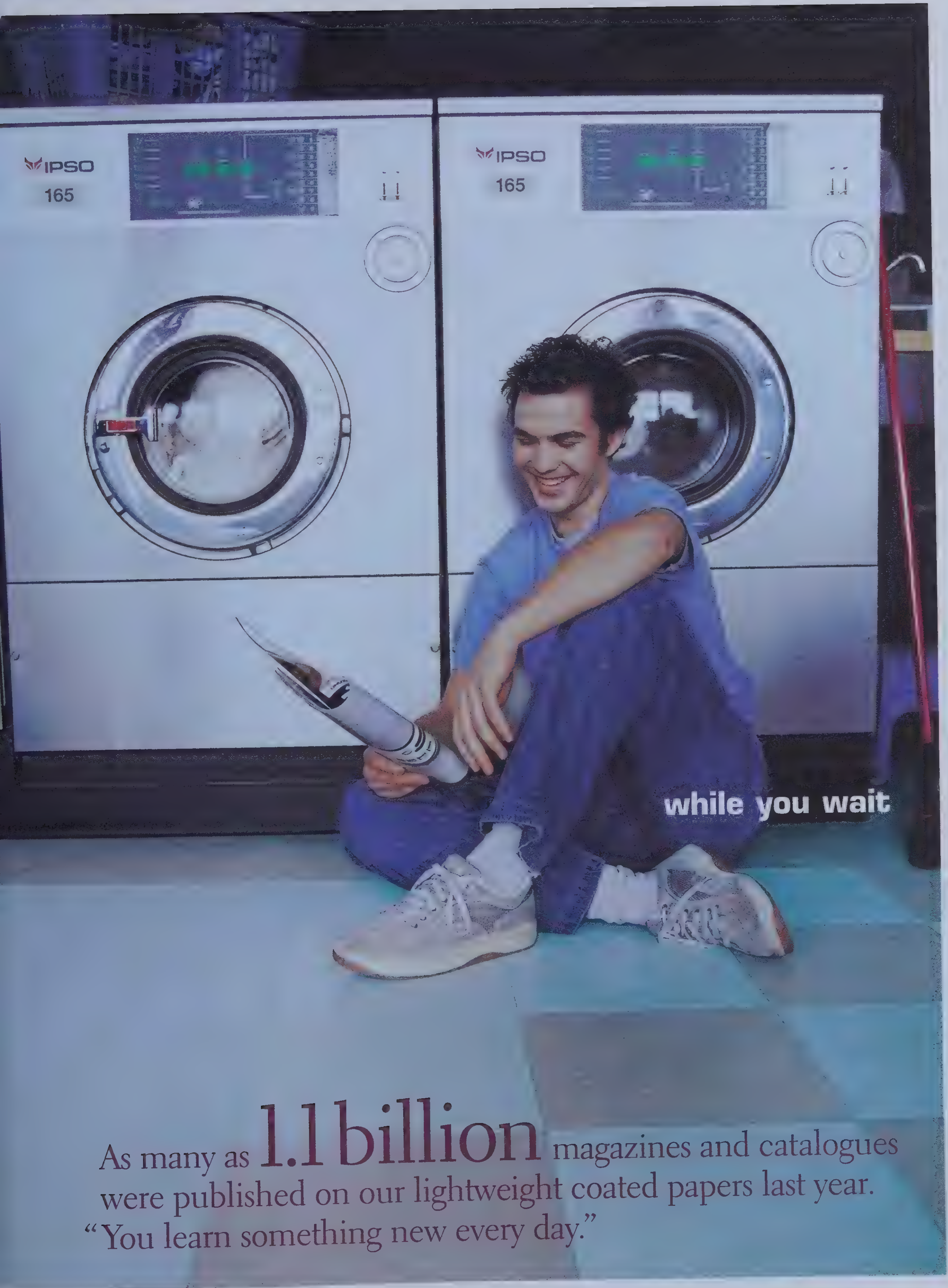
# Close to half of all Bibles purchased in the U.S. last year were printed on our lightweight paper. "Spread the word."


in your face
Dozens of food packaging products, from gum wrappers to candy pouches to popcorn bags, are made with our technical papers.
“Bang!”

# Our paper stock wrapped 8 billion burgers and sandwiches last year. "Care for fries with that?"

Roughly half
of all bandages
in the U.S.
& Canada
come wrapped
in Domtar paper.

# "Ouch!"

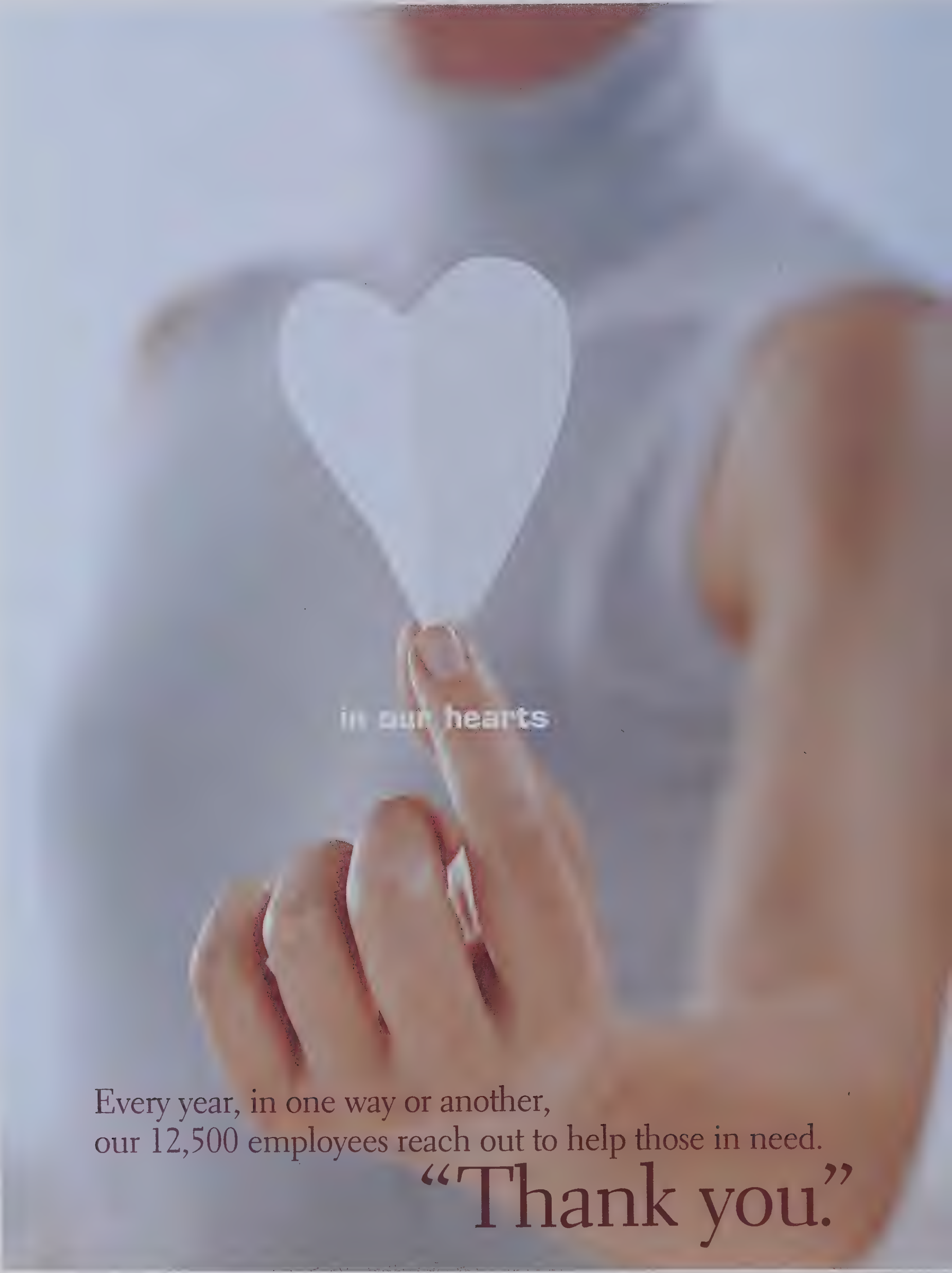

IPSO
165
IPSO
165
while you wait
As many as 1.1 billion magazines and catalogues were published on our lightweight coated papers last year.
"You learn something new every day."


Domtar makes lumber.
Enough to build
68,000 homes,
or a city the size of
Salt Lake City, each year.
"Whose turn is it
to walk Jasper?"
in your neck of the woods

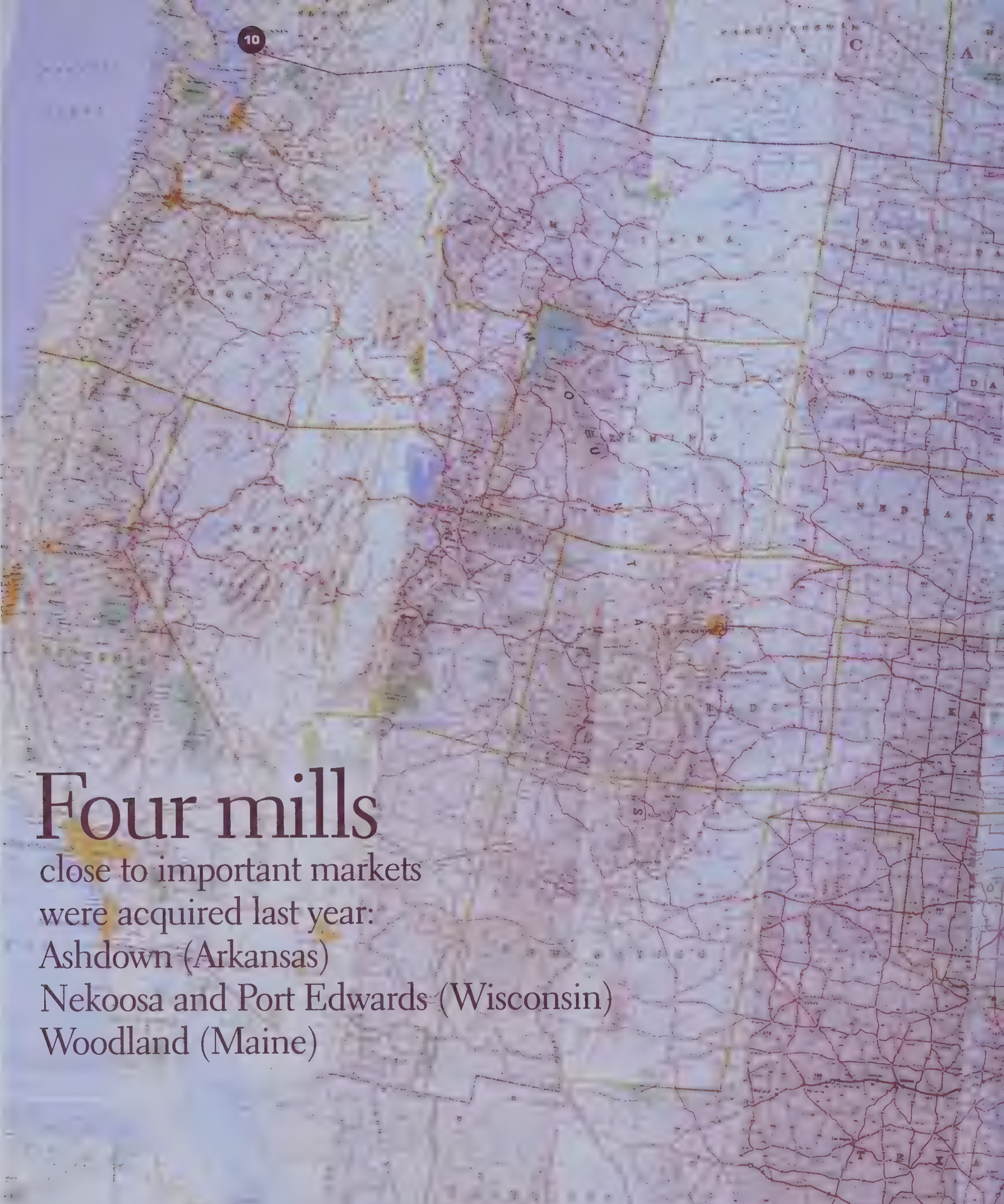

Surgical gowns made with one of our value-added technical papers are in operating rooms all across North America.

# "It's a boy... and a girl!"

*The person shown is not a medical practitioner and no representation to this effect is intended.


in our hearts
Every year, in one way or another,
our 12,500 employees reach out to help those in need.
"Thank you."

# As you can see, paper is no longer just paper. Paper is better, more specialized and stronger. And so are we.



# Four mills

close to important markets
were acquired last year:
Ashdown (Arkansas)
Nekoosa and Port Edwards (Wisconsin)
Woodland (Maine)

## Papers

1 Ashdown
2 Cornwall
3 Espanola
4 Lebel-sur-Quévillon
5 Nekoosa
6 Ottawa-Hull
7 Port Edwards
8 Port Huron
9 St. Catharines
10 Vancouver
11 Windsor
12 Woodland

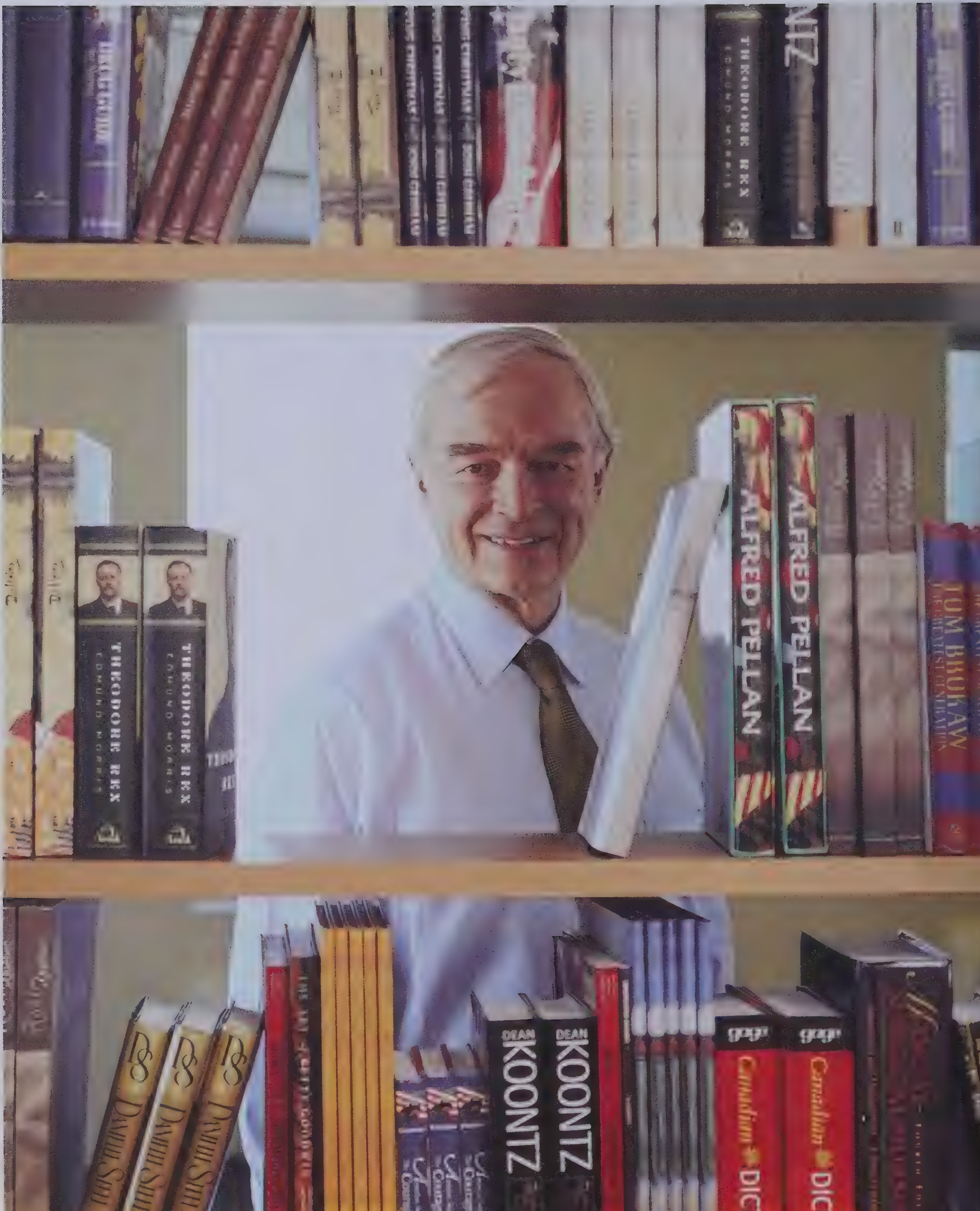
Our customers locate the paper products they need through our network of close to 150 independent merchants serving approximately 350 locations. (not represented on this map)


## Wood

- 13 Chapleau
- 14 Daveluyville
- 15 Elk Lake
- 16 Grand-Remous
- 17 Lebel-sur-Quévillon
- 18 Malartic
- 19 Matagami
- 20 Nairn Centre
- 21 Sault Ste. Marie
- 22 Ste-Aurélie
- 23 Ste-Françoise
- 24 Ste-Marie
- 25 Sullivan
- 26 Timmins
- 27 Val-d'Or
- 28 White River

## Head Office

- 29 Domtar Inc.

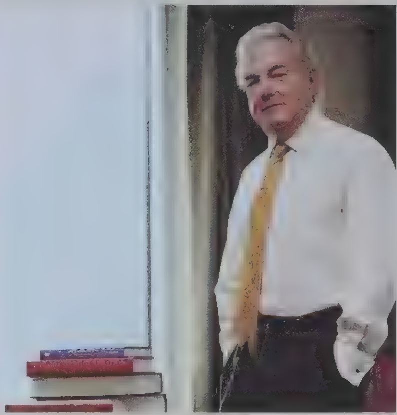



Raymond Royer, President and Chief Executive Officer of Domtar Inc.

# Letter to Shareholders

It is with great pride that we present the annual report of what many investors and analysts are already calling the "new" Domtar. There certainly have been many changes in our company in just a few short years. The acquisition of four American mills, concluded on August 7, 2001, represents the final phase of our strategy, announced in 1997: an undertaking to change Domtar into one of the strongest performers among North American paper companies in terms of return on shareholders' equity. As you no doubt recall, this strategy was accompanied by a precise plan that simultaneously promoted a focus on customers and their needs, the continuous improvement of productivity and quality in all our mills and the expansion of activities in the uncoated papers sector in order to attain the critical mass necessary to take on global competition.

The results obtained during this last phase once again confirm the soundness of our strategy. For the third consecutive year, Domtar has posted a return on shareholders' equity well above the pulp and paper industry average. Net earnings of $152 million in 2001 represent an 8% return on shareholders' equity—a good performance, considering that the selling prices for our products decreased an average of 6% over the year.



Jacques Girard, Chairman of the Board

### The Transformation of Domtar

The sweeping changes at Domtar over the last five years stem from several factors:
- rapid growth
- customer loyalty
- improved expertise and production capacity
- sense of responsibility
- ability to deliver superior returns

It is well worth reviewing these factors individually for a more precise image of our performance to date.

### Rapid Growth

In a period of less than five years, Domtar has managed to triple its sales, from $2 billion in 1997 to almost $6 billion, after an entire year's contribution by the four new American mills has been factored in. This figure puts Domtar into the North American industry's ninth spot at the beginning of 2002, far ahead of our 20th position of 1996.

The rapid rise in sales is mainly the result of three major acquisitions: E.B. Eddy in 1998, Ris Paper in 2000 and the four pulp and paper mills in the United States in 2001.

### Customer Loyalty

The purchase of E.B. Eddy strengthened our presence in the specialty papers sector. With the papers manufactured by the acquired mills added to those we were already producing, we accessed new markets and further increased customer loyalty. This expansion of our paper line addressed an urgent need among our merchants to offer customers a wider range of Domtar papers through one-stop shopping.

Before our acquisition of E.B. Eddy and its highly efficient distribution network, Domtar had already maintained a well-established network of independent merchants whose professionalism and effectiveness contributed greatly to our company's reputation. The integration of these two networks – which, by any standards, was rapidly achieved – means that we may now benefit from what has become the largest network of independent distributors in North America. We can offer just-in-time delivery of our papers, usually within 48 hours, to any major North American city.

The acquisition of Ris Paper has contributed to Domtar's growth by enlarging its business frontiers, enabling us to deepen our knowledge of the American market and interact directly with end users through a high-profile distributor.

But the milestone event in our geographic expansion was the acquisition of four pulp and paper mills in the United States: one in Arkansas (Ashdown), two in Wisconsin (Port Edwards and Nekoosa) and one in Maine (Woodland). With this purchase, Domtar doubled its size in the uncoated papers sector and rose to the No. 4 position worldwide in this category. Simultaneously, we established a significant presence in our main market, the United States, which now represents 80% of our total sales.

The acquisitions served to enrich our product line and dramatically increase our production capacity. Our mills now have enough geographic coverage to effectively serve the whole of the United States and Canada.

**Improved Expertise and Production Capacity**

With each new acquisition, Domtar's productivity increased remarkably, as the expertise and know-how of our paper design and manufacturing teams conquered new territory. In order to fully benefit from this wealth of expertise, we have set up a working group on best practices. Its mandate is to identify synergies and implement best practices throughout the company to achieve a more effective and higher quality performance.

This program was initiated after the acquisition of the four American mills, and depends on the contribution of some 300 employees in 22 work groups drawn from all our facilities. Their recommendations will save at least US$65 million annually.

Growth has been slower in the case of lumber, which contributes 8% of our sales. Overproduction, which often plagues the lumber market, poses a constant challenge to balance supply and demand. In order to stand out in this market, we have developed a three-pronged strategy: decrease wood consumption, improve the use of fibers, and focus on value-added products.

This strategy has already started paying off. We now use 20% fewer cubic meters of wood to produce the same quantity of board feet as five years ago, which represents a significant reduction in costs. In addition, with all our forest practices certified according to FSC (Forest Stewardship Council) or ISO 14001 standards, we are making better use of fiber, and can offer our customers products that comply with the strictest standards. Finally, reinvesting in our sawmill and forest management sectors has given us access to a high-end market with better selling prices for products.

In this sector, as in all other business activities, the "new" Domtar has begun a quality and profitability improvement program. This "Q&P" program, launched in early 2002 as part of our continuous improvement program established in 1997, is designed to identify ways to reduce costs and improve productivity and quality throughout all our activities. In addition to the results of our synergies program mentioned above, these measures should represent savings of CAN$100 million by the end of 2003.

We have also improved the profitability of our packaging sector with the creation of Norampac, in collaboration with Cascades Inc., in 1997. This innovative, dynamic partnership means we can participate in the growth of Canada's largest manufacturer of containerboard and corrugated containers, and we stand to gain considerable earnings.

**A Sense of Responsibility**

Throughout all the phases of Domtar's transformation, we have continued to demonstrate a heightened awareness of our environmental and social responsibilities. We are therefore pleased to report that Dow Jones has recognized our efforts and our initiatives by listing Domtar in its Sustainability Group Index for the third straight year.

Besides obtaining certification for all our forest management practices on forest-lands managed by Domtar, we have been active participants in the development of FSC standards for the Canadian boreal forest. Furthermore, our integrated mill in Cornwall has set a fine example by going all out this year to produce business and printing papers worthy of FSC certification. We have also been pursuing efforts to strengthen our good relations with the Aboriginal peoples who inhabit the lands where many of our forest operations take place, particularly by striving to involve them in our activities.

## Commitment to Solid Returns

Analysts are unanimous that Domtar's profile has radically changed, and that we represent a particularly attractive investment. We have offered a return on shareholders' equity far above the industry average over the last three years, and our stock value improved 18% in 2001 alone, with Domtar shares clearly outperforming the main stock indices.

Domtar offers a superior potential for return on investment, especially given the anticipated results from the two above-mentioned programs, the first one focusing on synergies generated by the acquisition of the four U.S. mills, and the second aimed at improving the quality of our products and services, as well as the productivity of our mills.

Our immediate objective is the flawless implementation and execution of both programs. They will offer our shareholders an enhanced investment return through their positive impact, and will strengthen our company's balance sheet by bringing the net-debt-to-total-capitalization ratio below 50% by the end of 2002. In keeping with the latter objective, and to improve our cash flow, capital expenditures for 2002 will be limited to approximately $290 million, or 75% of our annual amortization of $390 million.

## The Future

Domtar's transformation becomes readily apparent when we compare the diversity of our products and the scale of our distribution network to just a few short years ago. Progress has been most striking in the uncoated papers sector, which now accounts for 82% of our business.

Over the last five years, we have worked relentlessly on strengthening the ties between the three pillars of our company: customers, shareholders and employees. The enthusiastic response from our players and participants has provided a powerful incentive and resulted in highly encouraging financial results.

This same spirit and determination now inspires our future. First and foremost, 2002 shall be devoted to honoring our commitment to synergies and the Q&P program, in order to improve our balance sheet and offer shareholders even better returns. This is the surest way to realizing our growth objectives, within the framework of a sound balance sheet and for the greater benefit of our customers, employees and shareholders.

We cannot close this letter without a few words of thanks to our customers for their unflagging support. They have encouraged us to expand our product line and acquire more production capacity.

We wish to convey our gratitude to our personnel for their determination, commitment and team spirit, which has allowed Domtar to stand out from its competition.

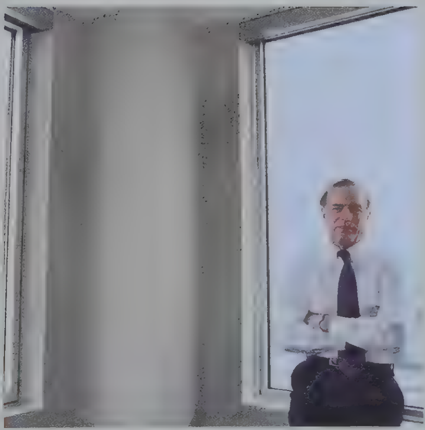
We would also like to thank the members of our Board of Directors. We truly value their sound advice and the ease it has brought to our decision-making process.

We know that, together, we can raise Domtar to new heights.

Raymond Royer
President and Chief Executive Officer

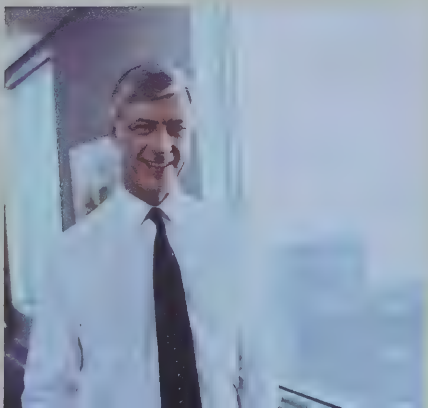
Jacques Girard
Chairman of the Board

## A strong team. And not just on paper.



**Members of the Management Committee**

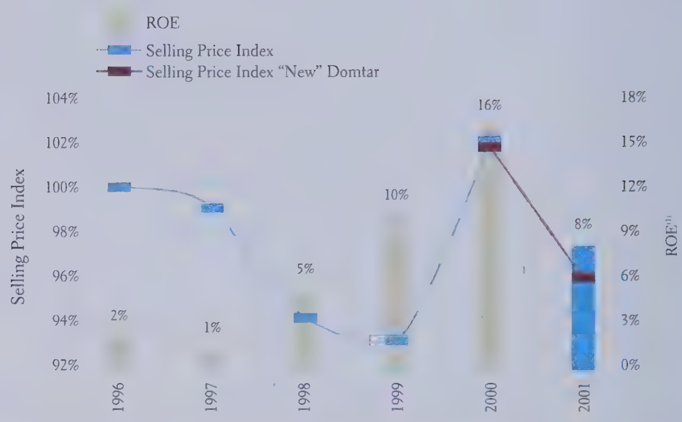
From left to right, starting from the top:
**Roland Gagnon**, Senior Vice-President–
Canadian Pulp and Paper Manufacturing Group
**Claude Belley**, Senior Vice-President–
Human Resources and Organizational Development
**E. Craig McManus**, Senior Vice-President–
Forest Resources Group
**George Kobrynsky**, Senior Vice-President–
Pulp and Paper Sales, Marketing and
Customer Relations Group
**Christian Dubé**, Senior Vice-President
and Chief Financial Officer
**C. Lance Skerratt**, Senior Vice-President–
Paper Merchants Group
**Monique Martin**, Senior Vice-President–
Wood Products Group
**Roger H. Brear**, Senior Vice-President–
U.S. Pulp and Paper Manufacturing Group
**Gilles Pharand**, Senior Vice-President–
Corporate Affairs, General Counsel and Secretary



# the numbers

# Financial Information 2001

# MD&A




## Monitoring our ROE Performance

Of all the factors that can affect our ROE[1] performance, the selling price of our products is the one that stands out as being both the most important and the one that is subject to the largest fluctuation as a result of supply and demand. Most of our product selling prices are influenced by, among other things, North American and world economic conditions. For instance, NBSK pulp prices fluctuated from a high of US$710/tonne in 2000 to a low of US$490/tonne in 2001, a 31% fluctuation.

In order to benchmark our ROE performance from one year to the next, we have developed a selling price index that regroups our key products. The index is based on benchmark prices in U.S. dollars for some of our key products (taken from publicly available sources) weighted for the relative production volumes for each product. Actual transaction prices may vary from these benchmarks, but we believe them to be a good general indication of the market. The year 1996 was used as our base year. Therefore, 1996 pricing was at 100% on the selling price index. Due to our acquisition in August 2001 of four integrated pulp and paper mills in the U.S., our product offering has changed significantly. Accordingly, we have calculated the selling price index for 2000 and 2001 using our new product offering, which more adequately captures the realities of the "New" Domtar.

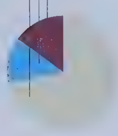
| Benchmark nominal prices for some of our key products | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 |
|---|---|---|---|---|---|---|
| Papers | | | | | | |
| Copy 20 lb (US$/ton) | 848 | 769 | 780 | 778 | 877 | 815 |
| Offset 50 lb rolls (US$/ton) | 736 | 756 | 666 | 659 | 757 | 719 |
| Coated publication, No.3, 60 lb, rolls (US$/ton) | 943 | 941 | 909 | 851 | 948 | 853 |
| Pulp NBSK (US$/tonnes) | 586 | 588 | 544 | 541 | 685 | 558 |
| Wood | | | | | | |
| Lumber 2x4x8 (US$/MFBM) | 403 | 383 | 376 | 390 | 316 | 345 |
| Packaging | | | | | | |
| Linerboard 42 lb (US$/ton) | 371 | 336 | 373 | 400 | 468 | 445 |

Source: *Pulp & Paper Week and Random Lengths.*

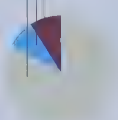
(1) ROE (Return on common shareholders' equity) is calculated as net earnings applicable to common shareholders divided by average common shareholders' equity. The 1997 figure excludes a non-recurring $17-million after-tax gain realized on the contribution of Domtar's packaging net assets to Norampac in 1997. The 1996 figure excludes non-recurring items related to the divestitures of the Gypsum and Decorative Panels divisions, a charge related to the refinancing program completed during the year and a charge principally related to asset write-downs.

The Management's Discussion and Analysis contains statements that are forward-looking in nature. Such statements involve known and unknown risks and uncertainties, such as: general economic and business conditions, product selling prices, raw material and operating costs, changes in foreign currency exchange rates, our ability to integrate acquired businesses into our existing operations, and other factors referenced herein and in the Corporation's continuous disclosure filings. Therefore, the actual results of the Corporation may be materially different from those expressed or implied by such forward-looking statements. Except where otherwise indicated, all financial information reflected herein is expressed in Canadian dollars and determined on the basis of Canadian generally accepted accounting principles (Canadian GAAP).

**Pre-Acquisition**
(based on Year 2000 net sales)




**Post-Acquisition**
(based on Year 2000 net sales)




## Our Business

Domtar's reporting segments correspond to the following business activities: Papers, Wood and Packaging.

### Papers

Our Papers business includes the production and distribution of papers from three principal product categories: business; printing and publishing; and technical and specialty. This business is supported by a large North American distribution network of close to 150 independent merchants and two Domtar-owned merchants. The Papers business also includes the production and sale of pulp. As discussed below, the relative impact of our Papers business has increased dramatically due to our acquisition of four U.S. mills in the third quarter of 2001.

### Wood

Our Wood business includes the harvesting, manufacture and distribution of lumber and wood-based value-added products as well as the management of Domtar's fiber resources.

### Packaging

Our Packaging business comprises Domtar's 50% ownership interest in Norampac, a joint venture between Domtar Inc. and Cascades Inc. Norampac manufactures and distributes containerboard and corrugated products. It has independent management and is self-financed based on its own operations and balance sheet. As required by Canadian GAAP, we account for our 50% interest in Norampac by the proportionate consolidation method.

## The "New" Domtar

On August 7, 2001, we acquired four integrated pulp and paper mills and related assets (the Acquired Mills) from Georgia-Pacific Corporation for US$1.65 billion in cash (the Acquisition). The Acquired Mills are located in Ashdown, Arkansas; Nekoosa and Port Edwards, Wisconsin; and Woodland, Maine. Collectively, these mills have 13 paper machines and an aggregate annual production capacity of approximately 1.35 million tons(1) of uncoated freesheet paper. They also produce approximately 360,000 tonnes(1) of pulp in excess of their annual internal needs. The Ashdown mill is one of the largest and lowest cost uncoated freesheet paper and converting operations in North America. As a result of the Acquisition, we approximately doubled our paper production capacity, becoming the third largest producer of uncoated freesheet paper in North America and the fourth largest worldwide. In this way, the Acquisition has helped us gain critical mass in a rapidly consolidating industry.

The Acquisition has increased the relative importance of our Papers business, in particular uncoated freesheet products. Accordingly, our historical results of operations may not be indicative of our future results. The charts above show the relative proportion of our net sales by business for the year ended December 31, 2000 on an historical basis (including Ris Paper(2) for five months) and on a pro forma basis giving effect to the Acquisition and the inclusion of Ris Paper for 12 months.

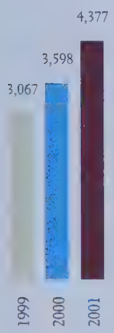
(1) The term "ton" refers to a short ton, an imperial unit of measurement which equals 0.9072 metric tonnes, and the term "tonne" refers to a metric tonne.
(2) Ris Paper Company, Inc. (Ris Paper), a paper distribution company in the United States, acquired on July 31, 2000.

Our principal paper product categories consist of business papers, printing and publishing papers, and technical and specialty papers. The following chart illustrates our principal paper products and our annual production capacity:

| **Categories** | Business papers | | Printing and publishing papers | | | Technical and specialty papers |
|---|---|---|---|---|---|---|
| **Types** | Uncoated freesheet | | | | Coated freesheet | Uncoated and coated freesheet |
| **Grades** | Copy | Premium imaging | Offset<br>Business converting | Lightweight<br>Opaques<br>Text and cover | Lightweight<br>Premium<br>Regular | Flexible packaging<br>Abrasive papers<br>Decorative papers<br>Imaging papers<br>Label papers<br>Medical disposables |
| **Applications** | Photocopies<br>Office documents<br>Presentations | | Pamphlets<br>Brochures<br>Direct mail<br>Commercial printing<br>Forms & envelopes | Stationery<br>Brochures<br>Annual reports<br>Books<br>Catalogues | Brochures<br>Annual reports<br>Books<br>Magazines<br>Catalogues | Food & candy wrappings<br>Surgical gowns<br>Repositionable note pads<br>Security check papers<br>Wallpapers |
| **Capacity*** | **Pre-Acquisition: 1,430,000 tons** | | | | | |
| | 210,000 tons (15%) | 30,000 tons (2%) | 340,000 tons (24%) | 280,000 tons (19%) | 400,000 tons (28%) | 170,000 tons (12%) |
| | **Post-Acquisition: 2,780,000 tons** | | | | | |
| | 700,000 tons (25%) | 200,000 tons (7%) | 500,000 tons (18%) | 600,000 tons (22%) | 400,000 tons (14%) | 380,000 tons (14%) |

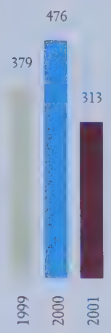
* The allocation of production capacity may vary from year to year in order to take advantage of market conditions.

**Net sales**
(in millions of CAN$)

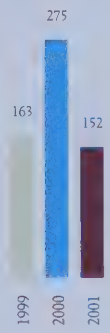



**EBITDA**
(in millions of CAN$)

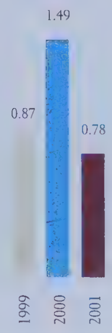

**Operating profit**
(in millions of CAN$)



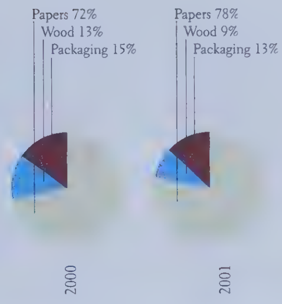

**Net earnings**
(in millions of CAN$)




**Net earnings per share**
(basic) ($)




**Net sales allocation by segment**




## 2001 Highlights

### Net Sales of $4.4 Billion

Net sales in 2001 totaled $4,377 million, up $779 million (or 22%) from net sales of $3,598 million in 2000. This increase was mainly due to the inclusion of net sales of the Acquired Mills for five months in 2001, the inclusion of net sales of Ris Paper for the full year in 2001 compared to five months in 2000, as well as the inclusion of our share of net sales of the acquisitions made by Norampac in 2001. Net sales were also favorably impacted by a stronger U.S. dollar, net of costs related to our hedging program. Excluding the impact of the acquisitions mentioned above, net sales in 2001 would have amounted to $3,295 million, a $303 million decrease compared to net sales of $3,598 million in 2000. This decrease was mainly due to lower transaction prices for all our products (except for lumber) and lower shipments for all our businesses that resulted from production curtailments we have taken in order to adjust production to customers' needs.

### Operating Profit of $313 Million

Cost of sales increased by $811 million (or 30%) in 2001 compared to 2000, due mainly to the inclusion of the Acquired Mills, Ris Paper, and our share of Norampac's acquisitions made in 2001, as well as a $30 million increase in energy costs and increases in certain other production costs. The impact of these increases was partially offset by lower shipments for all of our businesses (excluding the impact of the acquisitions mentioned above) and lower purchased fiber costs.

Selling, general and administrative (SG&A) expenses increased by $76 million (or 42%) in 2001 compared to 2000. This increase was mainly due to the inclusion of SG&A expenses of Ris Paper, the Acquired Mills and our share of Norampac's acquisitions made in 2001.

In 2000, we announced our objective of adding $100 million to our operating profit by the end of 2003, expecting to achieve one-third of this figure in 2001. We did not reach our 2001 target due to the impact of significant downtime related to major capital projects and to market conditions in each of our businesses, labor disruptions in our Wood business and increases in certain other production costs. Nonetheless, our goal of improving our profitability by $100 million by the end of 2003 remains in place, and we intend to achieve it through a new Quality and Profitability (Q&P) Program initiated in January 2002.

As a result of the factors mentioned above, EBITDA (earnings before financing expenses, income taxes and amortization) amounted to $607 million in 2001 compared to $715 million in 2000, and operating profit in 2001 amounted to $313 million compared to $476 million in 2000.

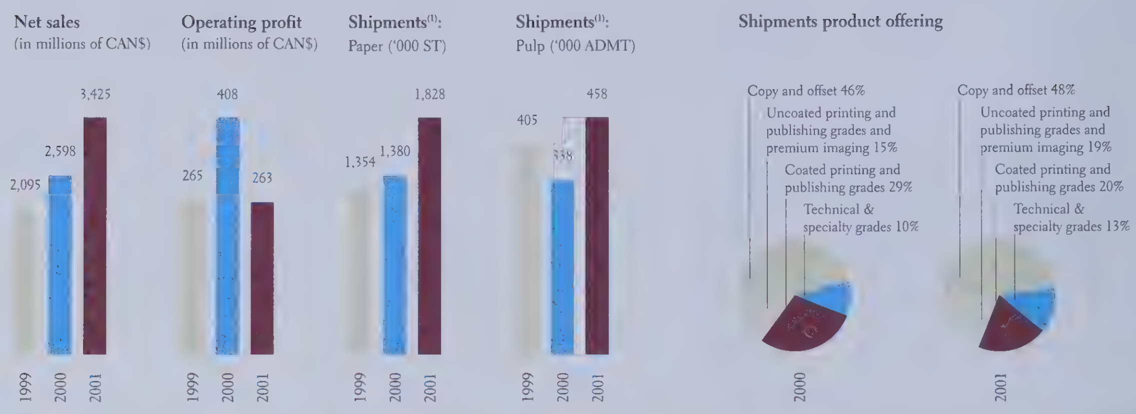
### Net Earnings of $152 Million and ROE of 8%

Net earnings amounted to $152 million ($0.78 per common share) in 2001 compared to $275 million ($1.49 per common share) in 2000. The 2001 net earnings include earnings from non-recurring items primarily due to cashing in of certain insurance policies as well as a reduction in statutory enacted income tax rates, representing $9 million ($0.05 per common share) and $39 million ($0.20 per common share), respectively. For the year ended December 31, 2000, a reduction in statutory enacted income tax rates and a revaluation of future income tax assets resulted in a reduction in income tax expense of $30 million ($0.16 per common share).

In 2001, we delivered an 8% ROE, and this in a difficult economic context, as evidenced by the 6% decrease in our selling price index, compared to an ROE of 16% in 2000.

### Free Cash Flow

We generated free cash flow (cash flows from operating activities less net capital expenditures) of $441 million in 2001, compared to $345 million in 2000. Excluding net proceeds received from the sales of receivables, free cash flow in 2001 amounted to $263 million in a difficult market environment compared to $285 million in 2000.




## Papers

### Sales, Shipments and Operating Profit

Net sales of paper and pulp, representing 78% of consolidated net sales in 2001, amounted to $3,425 million, an increase of $827 million (or 32%) compared to 2000. This increase was primarily due to the inclusion of five months of net sales of the Acquired Mills, as well as the inclusion of net sales of Ris Paper for the full year in 2001 compared to five months in 2000. These were partially offset by the effect of significant decreases in transaction prices and, excluding the impact of the acquisitions mentioned above, lower shipments for both paper and pulp.

Operating profit in the Papers business amounted to $263 million in 2001, a 36% decrease compared to $408 million in 2000. This decrease was primarily due to lower prices and shipments for both paper and pulp, as well as higher energy and other production costs. These were partially offset by the inclusion of operating profit of the Acquired Mills and by the favorable effect of a stronger U.S. dollar, net of costs related to our hedging program.

### Pricing Environment

In 2001, average transaction prices for 20 lb copy sheets (business papers) and 50 lb offset rolls (uncoated printing and publishing papers) decreased by US$36/ton compared to 2000.

In 2001, the weighted average transaction price for all our uncoated printing & publishing papers and premium imaging papers decreased by US$38/ton compared to 2000.

The weighted average transaction price for all our coated printing & publishing papers in 2001 decreased by US$20/ton compared to 2000.

The weighted average transaction price for all our technical & specialty grades in 2001 decreased by US$179/ton compared to 2000. The decrease in prices experienced during 2001 was mainly due to the new product offerings included in this grade caused by the addition of products from the Acquired Mills.

Market pulp conditions deteriorated throughout 2001, despite efforts made by certain major Canadian producers to curtail production in order to reduce inventory levels. In 2001, Northern Bleached Softwood Kraft (NBSK) and Northern Bleached Hardwood Kraft (NBHK) pulp transaction prices fell by an average of US$164/tonne compared to 2000.

### Production Efficiency

In the Papers business, our efforts to improve competitiveness continued, with further production efficiencies achieved through numerous Kaïzen continuous improvement workshops and the utilization of statistical process controls.

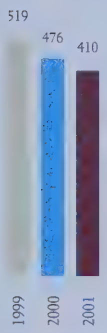
In 2001, we took market and major capital expenditure-related downtime, allowing us to curtail production by 95,000 tons of paper, representing approximately 5% of our 2001 production capacity, and 37,000 tonnes of pulp, representing approximately 7% of our 2001 production capacity. This reflects our commitment to adjust production to our customers' needs.

Our quality improvement project at the Windsor mill was completed in September 2001. The start-up period was longer than anticipated, but we are beginning to see expected improvements in paper quality. Our co-generation project, also located at our Windsor mill, was inaugurated at the end of October 2001. The co-generation plant supplies an average 25,000 kw annually, or 30% of the mill's total electricity consumption.

Six-year collective labor agreements were signed with our new employees at both the Ashdown and Woodland mills, providing for future stability in labor relations that will foster future production efficiencies.

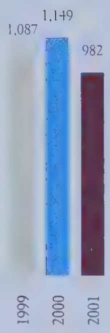
(1) Shipments of manufactured products only and excluding third party products sold by Domtar-owned merchants.

**Net sales**
(in millions of CAN$)

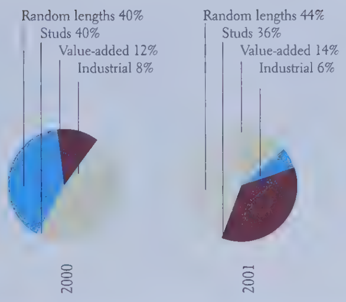



**Operating profit (loss)**
(in millions of CAN$)


**Shipments**
(in millions of FBM)




**Shipments product offering**




## Wood

### Sales, Shipments, and Operating Profit

Net sales in the Wood business, representing 9% of consolidated net sales in 2001, amounted to $410 million, a decrease of $66 million (or 14%) compared to 2000. Net sales decreased primarily as a result of a decline in shipments which was due to lower demand, temporary downtime, as well as to the fact that our Nairn Center sawmill only resumed regular activities in October 2001, following a prolonged strike that resulted in a six-year collective labor agreement. Although transaction prices were relatively stable compared to 2000, net sales were negatively affected by a $20 million provision recorded for potential countervailing and antidumping duties on exports of softwood lumber to the United States.

As a result of the factors mentioned above and additional costs related to the start-up of new equipment at several sawmills, the operating loss amounted to $46 million in 2001 compared to an operating loss of $33 million in 2000.

### Pricing Environment

In 2001, average transaction prices for random lengths (representing 44% of 2001 volumes) decreased by US$10/MFBM, while prices for Great Lakes 2x4 studs (representing 36% of 2001 volumes) increased by US$20/MFBM compared to 2000. Our transaction prices do not reflect the negative effect of potential countervailing and antidumping duties.

### Production Efficiency

In the Wood business, we continued to pursue our sawmill modernization plan aimed at improving profitability, which was announced in April 2000. During 2001, we completed the installation of new debarkers, saw lines and graders at several of our sawmills.

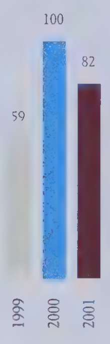
We are also upgrading our product offering and selling more of our products through long-term contracts, in an attempt to create a more stable customer base. During 2001, our product offering continued to improve, as shipments of value-added products reached 14% of total volume compared to 4% in 1998.

In addition, Anthony-Domtar Inc., a 50-50 joint venture between Anthony Forest Products Company and Domtar Inc., has built a new state-of-the-art manufacturing facility in Sault Ste. Marie that will manufacture a high quality wood I-joist, called the Power JoIst™, in order to generate a more stable demand for certain of our lumber products. The joint venture is expected to be fully operational by mid-year 2002. This plant received APA (American Plywood Association) Product Certification in early January 2002.

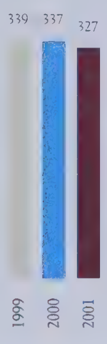
We completed our goal of certifying all of our forest management practices in compliance with either ISO 14001 or FSC (Forest Stewardship Council) standards. We have now obtained certification for the 22 million acres of forest-land that we manage directly.

**Net sales**
(in millions of CAN$)

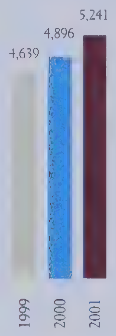

**Operating profit**
(in millions of CAN$)




**Shipments[1]:**
Containerboard
('000 MT)




**Shipments[1]:**
Corrugated containers
(in millions of square feet)




## Packaging

### Sales, Shipments, and Operating Profit

Our 50% share of Norampac's net sales, representing 13% of consolidated net sales in 2001, amounted to $542 million, an increase of $18 million (or 3%) compared to 2000. This was primarily due to an increase in shipments related to Norampac's recent acquisitions, partially offset by lower product prices and market-related downtime.

Our 50% share of Norampac's operating profit amounted to $82 million, a decrease of $18 million, or 18%, from the $100 million reported in 2000. These results reflected the decline in average transaction prices of containerboard and corrugated products and the impact of market-related downtime taken at the mills, partially offset by profitability generated from the newly acquired mills.

### Pricing Environment

Overall, containerboard transaction prices in 2001 decreased by US$27/ton compared to 2000. The limited reduction in pricing within a weak economic environment reflected the impact of production curtailment by major industry participants, including Norampac.

### Production Efficiency

During 2001, Norampac took market-related downtime at its containerboard mills for a total of 120,000 tonnes, representing approximately 9% of the annual capacity. This reflects Norampac's commitment to adjust production to customers' needs.

## Financing Expenses and Income Taxes

### Financing Expenses

During 2001, financing expenses, net of interest income, were $152 million, a $51 million increase compared to 2000, mainly due to the additional indebtedness we incurred in relation to the Acquisition.

### Income Taxes

Our effective tax rate for 2001 was 8.4% compared to 27.6% for 2000. In 2001, a reduction in statutory enacted income tax rates resulted in a reduction in income tax expense of $39 million. In 2000, a reduction in statutory enacted income tax rates and a revaluation of future income tax assets resulted in a reduction in income tax expense of $30 million. Excluding the non-recurring reductions mentioned above, the effective tax rate was 31.9% in 2001 compared to 35.5% in 2000. This reduced effective tax rate in 2001 reflects lower overall income taxes applicable to Domtar Inc. and its subsidiaries in certain jurisdictions.

## Liquidity and Capital Resources

Our principal liquidity requirements are for working capital, capital expenditures, and principal and interest payments on our debt. We will fund our liquidity needs primarily with internally generated funds from our operations and, to the extent necessary, through borrowings under our revolving credit facility.

Cash flows from operating activities in 2001 amounted to $727 million, an increase of $140 million compared to $587 million in 2000. The increase was mainly due to net proceeds of $178 million in 2001 compared to $60 million in 2000 from the sales of receivables. We expect to continue to sell receivables in the future on an ongoing basis, since the implicit interest rate on sales of receivables is lower than the interest rate on our borrowings. If we are unable to do so in the future, our working capital requirements would increase.

Net capital expenditures amounted to $286 million in 2001, a $44 million increase over the 2000 level, although $8 million below our annual amortization. The increase in capital expenditures resulted primarily from capital spending relating to the Acquired Mills and spending on several major capital projects underway since the beginning of the year. These

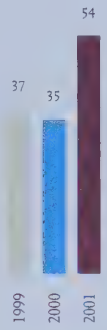
(1) Represents 50% of Norampac's shipments.

**Cash flows provided from operating activities** (in millions of CAN$)


**Net capital expenditures** (in millions of CAN$)


**Free cash flow** (in millions of CAN$)


**Net debt-to-total capitalization ratio** (in %)




capital projects included a quality improvement project and a co-generation project at the Windsor mill, the implementation of a company-wide enterprise resource planning system, and several efficiency projects in our sawmills. We anticipate annual maintenance capital expenditures, to approximate $140 million. We intend to limit our annual capital expenditures for the next two years to 75% of amortization, which, including maintenance capital expenditures, should represent approximately $290 million of capital projects in 2002.

Free cash flow (cash flows from operating activities less net capital expenditures) in 2001 totaled $441 million compared to $345 million in 2000. Free cash flow in 2001 was applied primarily to debt reduction. When excluding the net proceeds received from the sales of receivables of $178 million in 2001 and $60 million in 2000, free cash flows amounted to $263 million in 2001 in a difficult market environment, compared to $285 million in 2000.

In connection with the Acquisition, we entered into a new US$2.4 billion credit facility on August 7, 2001. The credit facility consisted of a five-year US$1.0 billion term loan, a five-year US$500 million unsecured revolving credit facility, a 12-month bridge loan of $460 million, or US$300 million (equity bridge loan) and a 12-month bridge loan of US$600 million (bond bridge loan). We used this new credit facility to pay the Acquisition price and to refinance amounts outstanding under the existing bank credit that was being replaced. In addition, on September 1, 2001, we redeemed our outstanding 10.35% debentures due in 2006 at a redemption price of 101.2% of the principal amount of $49 million, using the proceeds of the Acquisition credit facility.

In October 2001, we completed the public offering of 45.2 million common shares in Canada and the United States (at a price of $11.44 per common share) for net proceeds of $499 million and unsecured long-term notes in the United States (US$600 million with a coupon of 7.875% maturing in 2011) for net proceeds of $925 million. The net proceeds from the offering were used to repay the equity bridge loan and the bond bridge loan as well as part of the bank term loan.

In 2001, in order to reduce the initial interest on the 7.875% notes payable, we entered into interest rate swaps totaling US$600 million which will have the effect of exposing Domtar to floating interest rates with respect to US$300 million of nominal debt from October 2002 to October 2006, and to an additional US$300 million of nominal debt from October 2003 to October 2006.

As at December 31, 2001, our net debt-to-total-capitalization ratio was 54% compared to our net debt-to-total-capitalization ratio of 35% at December 31, 2000 and approximately 65% at the date of the Acquisition. Net indebtedness, including our 50% share of the net indebtedness of Norampac of $188 million, was $2,874 million at December 31, 2001 compared to $985 million at the end of 2000. The off balance sheet sales of receivables represented $238 million as at December 31, 2001 compared to $60 million as at December 31, 2000.

As at December 31, 2001, the remainder of the term loan totaled US$730 million as Domtar repaid US$270 million from cash flows from operations, including the sales of receivables, as well as from excess proceeds from the common share public offering. The term loan bears interest based on the U.S. dollar LIBOR rate, or the U.S. prime rate, plus a margin that varies with Domtar's credit rating.

As at December 31, 2001, $15 million of the US$500 million revolving credit facility was drawn and letters of credit totaling $11 million were outstanding, resulting in US$484 million of availability under this facility. At the end of 2000, $212 million of our previous revolving credit facility was drawn and letters of credit totaling $8 million were outstanding. Borrowings under the existing revolving credit facility bear interest at a rate based on Canadian dollar bankers' acceptance or U.S. dollar LIBOR rate or the prime rate, plus a margin that varies with Domtar's credit rating.

The indentures or agreements under which some of our debt was issued contain covenants, including a limitation on the amount of dividends on our shares that we may pay, on the amount of shares that we may repurchase for cancellation and on the amount of term loan we may incur. Our bank facilities contain certain restrictive quarterly covenants. Our US$500 million unsecured revolving credit facility also requires commitment fees in accordance with standard banking practices.

As at February 28, 2002, 226,635,962 common shares, 69,576 Series A Preferred Shares and 1,810,000 Series B Preferred Shares were issued and outstanding.

## 2000 Compared to 1999

Net sales in 2000 totaled $3,598 million, up $531 million (or 17%) from $3,067 million in 1999. The five-month inclusion of the results of Ris Paper, higher average selling prices in two of our businesses, Papers and Packaging, and higher shipments explain this increase. These factors more than offset the impact of significantly weaker prices in lumber.

Operating profit reached $476 million in 2000, an increase of 26% compared to $379 million in 1999. This $97 million year-over-year improvement was a result of price increases in paper, pulp and packaging, an increase in shipments of value-added products and operational improvements at our manufacturing facilities. However, these results were partially offset by significantly lower prices for lumber, an unprecedented increase in energy costs, reorganization charges in the Wood business and market-related shutdowns.

In 2000, we reported net earnings of $275 million ($1.49 per common share), a 69% increase over the $163 million recorded in 1999 ($0.87 per common share), and achieved a 16% ROE compared to 10% in 1999. The 2000 net earnings include a reduction in income tax expense of $30 million ($0.16 per common share) arising from a reduction in statutory enacted income tax rates and a revaluation of future income tax assets.

## Risks and Uncertainties

### Prices, Economic Conditions, and Competition

Our operating results are sensitive to fluctuations in the prices of our products, among other things. The markets for papers, pulp, lumber and packaging products are cyclical and are influenced by a variety of factors beyond our control. These factors include periods of excess product supply due to industry capacity additions, periods of decreased demand due to weak general economic activity in North America or international markets, inventory de-stocking by customers and fluctuations in currency exchange rates.

The markets that we serve are large and highly fragmented, with a number of substantial companies operating in each sector. The major North American and international markets in which we sell our principal products are very competitive. Some of our competitors have greater financial, manufacturing and marketing resources than Domtar has and may be better positioned to withstand the adverse effect on margins and profitability caused by price decreases. In addition, our products are in competition with similar products produced by others, and in some instances, with products produced by other industries from other materials.

Our exports of lumber to the United States may be affected by any new agreement between Canada and the United States with respect to Canada's exports of softwood lumber to the United States. Under the old agreement, which expired on March 31, 2001, export taxes were imposed on Canadian lumber producers if certain export volumes to the United States were exceeded. On April 2, 2001 antidumping and countervailing duty applications were filed by various organizations with governmental authorities of the United States with respect to the imports of Canadian softwood lumber. In August 2001, the United States Department of Commerce made a preliminary determination to impose countervailing duties of 19.31% on Canadian softwood lumber. In October 2001, the United States Department of Commerce made a preliminary determination to impose antidumping duties of 12.6% on Canadian softwood lumber.

The Government of Canada is challenging these preliminary determinations. Sales of wood represent approximately 8% of our consolidated net sales on a pro forma basis giving effect to the Acquisition and the inclusion of Ris Paper for 12 months. We may experience reduced revenues and margins in our Wood business as a result of any new arrangement as well as antidumping and countervailing duty applications.

In addition, operating costs for our businesses can be affected by increases or decreases in energy and other raw material prices as a result of changing economic conditions or due to particular supply and demand considerations.

### Foreign Exchange

Our revenues for many of our products are affected by fluctuations in the exchange rate between the Canadian dollar and the U.S. dollar. The prices for many of our products, including those we sell in Canada, are principally driven by U.S. prices of similar products. As a result, any reduction in the value of the U.S. dollar relative to the Canadian dollar reduces the amount of Canadian dollar revenues we realize on sales. However, we hedge the value of a portion of our future U.S. dollar net cash inflows for periods of up to three years, in order to reduce the potential negative effect of a weakening U.S. dollar. Our hedging arrangements as at December 31, 2001 totalling US$1,106 million (of which US$681 million matures within 2002) protect the value of part of our expected net U.S. dollar cash inflows at an average exchange rate of 1.45 for the next three years, and they limit Domtar from benefiting from a higher U.S. dollar to a maximum of an average exchange rate of 1.51 for that same period.

### Environment

We are subject to environmental laws and regulations enacted by federal, provincial, state and local authorities. In 2001 and 2000, we made environmental capital expenditures of $16 million and $7 million, respectively, mostly for the improvement of air emissions. We are continuing to take remedial action at a number of current and former sites, due in part to soil and some groundwater contamination at these sites. As at December 31, 2001, we had a provision of $47 million for known and determinable site remediation costs, primarily in connection with our former wood preserving business, which was sold in 1993, and relating to sites in various provinces. Furthermore, we are party to some environmental claims, actions and lawsuits that are being contested. The process of investigation and remediation can be lengthy and is subject to the uncertainties of changing legal requirements, developing technologies, the allocation of liability among potentially responsible parties and the discretion of regulators.

### Legal Actions

In the normal course of our operations, we become involved in various legal actions. While the final outcome with respect to actions outstanding or pending as at December 31, 2001 cannot be predicted with certainty, it is our opinion that their resolution will not have a material adverse effect on our financial position, earnings or cash flows.

## Sensitivity Analysis

Our operating profit, net earnings and earnings per share can be impacted by the following sensitivities:

| (In millions of Canadian dollars, except per share amounts) | Annual impact on [c] | | |
|---|---|---|---|
| | Operating profit $ | Net earnings $ | Earnings per share $ |
| **Each US$10/unit change in price of:** [a] | | | |
| Papers | | | |
| Copy and offset | 22 | 14 | 0.06 |
| Uncoated printing & publishing and premium imaging grades | 9 | 6 | 0.03 |
| Coated printing & publishing grades | 6 | 4 | 0.02 |
| Technical & specialty grades | 6 | 4 | 0.02 |
| Pulp – net position | 9 | 6 | 0.03 |
| Wood | | | |
| Lumber | 15 | 10 | 0.04 |
| Packaging | | | |
| Containerboard | 11 | 7 | 0.03 |
| **Foreign exchange** | | | |
| CAN 1¢ change in relative value to the U.S. dollar | | | |
| after hedging [b] | 4 | 3 | 0.01 |
| before hedging | 10 | 6 | 0.03 |
| **Interest rate** | | | |
| 1% change in interest rates on our floating rate debt (excluding interest rate swaps) | N/A | 9 | 0.04 |

(a) Based on 2002 capacity (in tons, tonnes or MFBM).
(b) Based on currency hedging portfolio for the period January 1 – December 31, 2002.
(c) Based on an exchange rate of 1.55 and a marginal tax rate of 35%.

## Impact of Accounting Pronouncements Not Yet Implemented

### Stock-Based Compensation and Other Stock-Based Payments

In December 2001, the Canadian Institute of Chartered Accountants (CICA) issued new recommendations relating to stock-based compensation and other stock-based payments. Effective for the fiscal year beginning January 1, 2002, the recommendations require the use of a fair value-based approach of accounting for certain specified stock-based awards. For all other employee stock-based awards, the recommendations do not require that a fair value-based approach be used. The recommendations also address the accounting for stock appreciation rights and awards to be settled in cash, other financial assets and equity. Domtar does not expect the recommendations to have an initial material impact on its financial statements upon adoption.

### Foreign Currency Translation

In November 2001, the CICA issued amended recommendations relating to the accounting for foreign currency translation to eliminate the requirement to defer and amortize unrealized translation gains and losses on foreign currency denominated monetary items that have a fixed or ascertainable life extending beyond the end of the fiscal year following the current reporting period. The amendment is effective for the fiscal year beginning January 1, 2002 and must be applied retroactively with restatement of prior years. Had Domtar applied the new method in 2001, it would have recognized an additional foreign currency loss of $15 million ($10 million net of income taxes) and retained earnings as at December 31, 2001 would have been reduced by $31 million.

### Goodwill and Intangible Assets

In July 2001, the CICA issued new recommendations relating to the accounting for goodwill and other intangible assets that requires intangible assets with an indefinite life and goodwill arising from acquisitions completed after June 30, 2001 to no longer be amortized. Effective January 1, 2002, all goodwill and indefinite life intangible assets will no longer be amortized, and will be tested annually for impairment by comparing the fair value of the assets with their carrying amount. Intangible assets with a definite life will continue to be amortized over their useful life. Amortization expense related to goodwill was $4 million for the year ended December 31, 2001. Domtar will test its goodwill (amounting to $74 million as of December 31, 2001) for impairment upon adoption of the new recommendations and, if impairment is indicated, will record such impairment as a restatement to opening 2002 retained earnings.

## Outlook 2002

We believe that the uncertain economic conditions will continue to present some challenges to all our businesses. Despite this, we remain confident in the long-term fundamentals of the uncoated freesheet market. We will continue to strengthen our customer relationships, and we will also continue to closely monitor inventories in order to maintain optimal levels and meet the needs of our customers.

We believe the Acquisition will enable us to achieve significant operating improvements and cost reductions in our Papers business. We have established a Best Practices Steering Committee, the main task of which is to identify and monitor the achievement of synergies related to the Acquisition. The principal areas in which we believe we can realize operating improvements and cost reductions include: transportation and logistics, customer/product offerings, operational improvements, procurement power, best practices, and SG&A expense reductions. We are committed to meeting our objective of achieving an annualized run rate of US$65 million of synergies by the end of 2002. As at the end of January 2002, we reached US$10 million.

As a result of the Acquisition, Domtar has significantly changed. We therefore implemented a new Quality and Profitability (Q&P) Program, which is designed to increase profitability through higher efficiencies and improved customer/product offerings, and to reduce costs throughout our operations. Our target is to achieve additional profitability of approximately $100 million with these initiatives by the end of 2003, which will be in addition to the Acquisition-related synergies mentioned above.

Our goal is to continue delivering superior performance despite difficult market conditions and to take prompt advantage of any upswing in the economy.

**EVA®**
(in millions of CAN$)


**Return on Domtar Stock**
(Value of $100 invested on January 1st, 1996)


## Economic Value Added (EVA®)

In addition to using Return on Equity as an important financial metric, Domtar also uses EVA® to ensure that its decision-making processes are aligned with the objective of increasing shareholder value. EVA® is used at Domtar to measure performance and to evaluate investment decisions.

EVA® is positive when a company's net after-tax operating profit exceeds a capital charge representing the return expected by the providers of the company's capital. Domtar reviews its cost of capital annually, based on changes in the financial markets.

Domtar's EVA® for 2001 deteriorated to $125 million negative, due primarily to a weaker selling price environment.

Domtar remains committed to creating long-term shareholder value and will continue to emphasize its efforts in 2002, especially in areas under its control such as the synergies related to the Acquisition, the Quality and Profitability Program (Q&P) and capital management.

EVA® is a registered trademark of Stern Steward & Co.

## Common Stock Prices

Quarterly share prices for the common shares of Domtar during 2001 and 2000 were as follows:

| | 1st | 2nd | 3rd | 4th |
|---|---|---|---|---|
| | $ | $ | $ | $ |
| Market price – 2001 | | | | |
| Toronto Stock Exchange | | | | |
| High | 14.80 | 16.46 | 15.65 | 16.15 |
| Low | 11.00 | 12.95 | 11.51 | 11.15 |
| New York Stock Exchange (US$) | | | | |
| High | 9.49 | 10.71 | 10.12 | 10.16 |
| Low | 7.44 | 8.52 | 7.34 | 6.80 |
| Market price – 2000 | | | | |
| Toronto Stock Exchange | | | | |
| High | 22.00 | 17.45 | 15.05 | 13.90 |
| Low | 13.50 | 12.90 | 12.25 | 9.90 |
| New York Stock Exchange (US$) | | | | |
| High | 14.81 | 11.69 | 10.13 | 9.19 |
| Low | 9.50 | 8.81 | 8.25 | 6.63 |

## Management's Statement of Responsibility

The consolidated financial statements contained in this Annual Report are the responsibility of management, and have been prepared in accordance with Canadian generally accepted accounting principles. Where necessary, management has made judgments and estimates of the outcome of events and transactions, with due consideration given to materiality. Management is also responsible for all other information in the Annual Report and for ensuring that this information is consistent, where appropriate, with the information and data included in the consolidated financial statements.

To discharge its responsibility, management maintains a system of internal controls to provide reasonable assurance as to the reliability of financial information and the safeguarding of assets.

The Corporation's external auditors are responsible for auditing the consolidated financial statements and giving an opinion thereon. In addition, the Corporation maintains a staff of internal auditors whose functions include reviewing internal controls and their application on an ongoing basis.

The Board of Directors carries out its responsibility relative to the consolidated financial statements principally through its Audit Committee, consisting solely of outside directors, which reviews the consolidated financial statements and reports thereon to the Board. The Committee meets periodically with the external auditors, internal auditors and management to review their respective activities and the discharge of each of their responsibilities. Both the external auditors and the internal auditors have free access to the Committee, with or without management, to discuss the scope of their audits, the adequacy of the system of internal controls and the adequacy of financial reporting.

Raymond Royer
President and Chief Executive Officer

Christian Dubé
Senior Vice-President and Chief Financial Officer

Montréal, Québec, January 22, 2002

## Auditors' Report

To the Shareholders of Domtar Inc.

We have audited the consolidated balance sheets of Domtar Inc. as at December 31, 2001 and 2000 and the consolidated statements of earnings, retained earnings and cash flows for each of the years in the three-year period ended December 31, 2001. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of Domtar Inc. as at December 31, 2001 and 2000 and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2001 in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants

Montréal, Québec, January 22, 2002

Raymond Chabot Grant Thornton

Chartered Accountants
General Partnership

# Consolidated Financial Statements

## Consolidated Earnings

Years ended December 31

(In millions of Canadian dollars, unless otherwise noted)

| | 2001 | 2001 | 2000 | 1999 |
|---|---|---|---|---|
| | US$ (Note 3) | $ | $ | $ |
| **Net sales** | 2,748 | 4,377 | 3,598 | 3,067 |
| **Operating expenses** | | | | |
| Cost of sales | 2,206 | 3,514 | 2,703 | 2,297 |
| Selling, general and administrative | 161 | 256 | 180 | 162 |
| Amortization | 185 | 294 | 239 | 229 |
| | 2,552 | 4,064 | 3,122 | 2,688 |
| **Operating profit** | 196 | 313 | 476 | 379 |
| Financing expenses (Note 5) | 95 | 152 | 101 | 111 |
| Amortization of deferred gain | (3) | (5) | (5) | (5) |
| **Earnings before income taxes and non-controlling interest** | 104 | 166 | 380 | 273 |
| Income tax expense (Note 6) | 9 | 14 | 105 | 111 |
| **Earnings before non-controlling interest** | 95 | 152 | 275 | 162 |
| Non-controlling interest (Note 4) | – | – | – | (1) |
| **Net earnings** | 95 | 152 | 275 | 163 |
| **Per common share** (Note 7) | | | | |
| Net earnings | | | | |
| Basic | 0.49 | 0.78 | 1.49 | 0.87 |
| Diluted | 0.49 | 0.78 | 1.48 | 0.87 |

The accompanying notes are an integral part of the consolidated financial statements.

## Consolidated Retained Earnings

Years ended December 31

(In millions of Canadian dollars, unless otherwise noted)

| | 2001 | 2001 | 2000 | 1999 |
|---|---|---|---|---|
| | US$ (Note 3) | $ | $ | $ |
| **Retained earnings at beginning of year** | 350 | 557 | 504 | 373 |
| Cumulative effect of changes in accounting policies (Note 2) | – | – | (151) | – |
| Net earnings | 95 | 152 | 275 | 163 |
| Dividends on common shares | (17) | (27) | (25) | (26) |
| Dividends on preferred shares | (1) | (2) | (3) | (3) |
| Premium on purchase for cancellation of common shares | – | (1) | (43) | (3) |
| **Retained earnings at end of year** | 427 | 679 | 557 | 504 |

The accompanying notes are an integral part of the consolidated financial statements.

## Consolidated Balance Sheets

December 31

(In millions of Canadian dollars, unless otherwise noted)

| | 2001 | 2001 | 2000 |
|---|---|---|---|
| | US$ (Note 3) | $ | $ |
| **Assets** | | | |
| **Current assets** | | | |
| Cash and cash equivalents | 23 | 36 | 29 |
| Receivables (Note 8) | 188 | 300 | 404 |
| Inventories (Note 9) | 489 | 779 | 546 |
| Prepaid expenses | 15 | 24 | 19 |
| Future income taxes (Note 6) | 18 | 29 | 30 |
| | 733 | 1,168 | 1,028 |
| **Investments and advances** | 35 | 55 | 30 |
| **Property, plant and equipment** (Note 10) | 3,516 | 5,600 | 2,993 |
| **Other assets** (Note 11) | 175 | 279 | 216 |
| | 4,459 | 7,102 | 4,267 |
| **Liabilities and shareholders' equity** | | | |
| **Current liabilities** | | | |
| Bank indebtedness | 28 | 45 | 47 |
| Trade and other payables (Note 12) | 452 | 719 | 532 |
| Income and other taxes payable | 12 | 19 | 20 |
| Long-term debt due within one year (Note 13) | 24 | 38 | 41 |
| | 516 | 821 | 640 |
| **Long-term debt** (Note 13) | 1,803 | 2,872 | 973 |
| **Future income taxes** (Note 6) | 339 | 541 | 569 |
| **Other liabilities and deferred credits** | 256 | 408 | 254 |
| **Commitments and contingencies** (Note 14) | | | |
| **Shareholders' equity** | | | |
| Preferred shares (Note 15) | 30 | 48 | 51 |
| Common shares (Note 15) | 1,087 | 1,731 | 1,224 |
| Retained earnings | 427 | 679 | 557 |
| Accumulated foreign currency translation adjustments (Note 17) | 1 | 2 | (1) |
| | 1,545 | 2,460 | 1,831 |
| | 4,459 | 7,102 | 4,267 |

The accompanying notes are an integral part of the consolidated financial statements.

Approved by the Board:

Jacques Girard

Jacques Girard, Director

Raymond Royer

Raymond Royer, Director

## Consolidated Cash Flows

Years ended December 31

(In millions of Canadian dollars, unless otherwise noted)

| | 2001 | 2001 | 2000 | 1999 |
|---|---|---|---|---|
| | US$ (Note 3) | $ | $ | $ |
| **Operating activities** | | | | |
| Net earnings | 95 | 152 | 275 | 163 |
| Non-cash items: | | | | |
| Amortization | 185 | 294 | 239 | 229 |
| Future income taxes | (16) | (26) | 75 | 99 |
| Amortization of deferred gain | (3) | (5) | (5) | (5) |
| Other | 13 | 21 | 9 | 1 |
| | 274 | 436 | 593 | 487 |
| Changes in working capital items | | | | |
| Receivables (Note 8) | 166 | 264 | 100 | (66) |
| Inventories | (16) | (25) | (24) | 17 |
| Prepaid expenses | (3) | (5) | 5 | (6) |
| Trade and other payables | 24 | 38 | (29) | (49) |
| Income and other taxes payable | 8 | 12 | (32) | (22) |
| Other | 4 | 7 | (26) | (35) |
| | 183 | 291 | (6) | (161) |
| Cash flows provided from operating activities | 457 | 727 | 587 | 326 |
| **Investing activities** | | | | |
| Net additions to property, plant and equipment | (179) | (286) | (242) | (201) |
| Business acquisitions, including cash acquired or bank indebtedness assumed (Note 4) | (1,643) | (2,616) | (22) | (9) |
| Other | 1 | 1 | (18) | 23 |
| Cash flows used for investing activities | (1,821) | (2,901) | (282) | (187) |
| **Financing activities** | | | | |
| Dividend payments | (18) | (28) | (28) | (28) |
| Change in bank indebtedness | (1) | (2) | (1) | 17 |
| Change in revolving bank credit, net of expenses | (123) | (196) | (163) | 198 |
| Issuances of long-term debt, net of expenses | 2,380 | 3,791 | – | – |
| Repayment of long-term debt | (1,180) | (1,879) | (6) | (305) |
| Common shares issued (repurchased), net of expenses | 313 | 498 | (78) | 5 |
| Redemptions of preferred shares | (2) | (3) | (3) | (32) |
| Cash flows provided from (used for) financing activities | 1,369 | 2,181 | (279) | (145) |
| **Net increase (decrease) in cash and cash equivalents** | 5 | 7 | 26 | (6) |
| **Cash and cash equivalents at beginning of year** | 18 | 29 | 3 | 9 |
| **Cash and cash equivalents at end of year** | 23 | 36 | 29 | 3 |

The accompanying notes are an integral part of the consolidated financial statements.

# Notes

December 31, 2001 (In millions of Canadian dollars, unless otherwise noted)

## 1. Summary of Significant Accounting Policies

The consolidated financial statements are expressed in Canadian dollars and have been prepared in accordance with Canadian generally accepted accounting principles (Canadian GAAP). These financial statements differ in certain respects from those prepared in accordance with United States generally accepted accounting principles (U.S. GAAP), and are not intended to provide certain disclosures which would typically be found in financial statements prepared in accordance with U.S. GAAP. These differences are described in Note 22.

### Basis of consolidation

The consolidated financial statements include the accounts of Domtar Inc. (the Corporation) and all its subsidiaries and joint ventures (collectively Domtar). Investments over which the Corporation exercises significant influence are accounted for using the equity method. The Corporation's interest in joint ventures is accounted for using the proportionate consolidation method.

### Use of estimates

The consolidated financial statements have been prepared in conformity with Canadian GAAP, which require management to make estimates and assumptions that affect the reported amounts of revenues and expenses during the year, the reported amounts of assets and liabilities, and the disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates.

### Translation of foreign currencies

*Self-sustaining foreign operations*

For foreign subsidiaries that are considered financially and operationally self-sustaining, the current rate method of translation of foreign currencies has been used. Under this method, assets and liabilities are translated into Canadian dollars at the rate in effect at the balance sheet date and the revenues and expenses are translated at average exchange rates during the year. All gains and losses arising from the translation of the financial statements of these foreign subsidiaries are included in the "Accumulated foreign currency translation adjustments" account under "Shareholders' equity."

*Foreign currency transactions and integrated foreign operations*

For foreign currency transactions and foreign subsidiaries that are considered financially and operationally integrated, the temporal method of translation of foreign currencies has been used. Monetary items are translated at the rate in effect at the balance sheet date, non-monetary items are translated at their historical rate (as well as the related amortization) and the revenues and expenses are translated at the rate in effect at the transaction date or at average exchange rates during the year as appropriate. Translation gains and losses, except those on long-term debt, are included in "Selling, general and administrative" expenses.

*Foreign currency long-term debt*

For debt designated as a hedge of the net investment in self-sustaining foreign subsidiaries, exchange gains and losses are included in the "Accumulated foreign currency translation adjustments" account. For the remaining long-term debt denominated in foreign currency, exchange gains and losses are deferred and amortized over the remaining term of the related obligation.

### Revenue recognition

Sales and cost of sales are recognized in accordance with the delivery terms. Domtar records delivery costs as a reduction of gross sales to determine net sales. For the year ended December 31, 2001, delivery costs amounted to $259 million (2000 – $215 million; 1999 – $204 million).

### Income taxes

Domtar uses the asset and liability method of accounting for income taxes. Under this method, future tax assets and liabilities are determined according to differences between the carrying amounts and tax bases of the assets and liabilities. The change in the net future tax asset or liability is included in income. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates and laws expected to apply in the years in which assets and liabilities are expected to be recovered or settled. Domtar does not provide for income taxes on undistributed earnings of foreign subsidiaries that are not expected to be repatriated in the foreseeable future.

### Cash and cash equivalents

Cash and cash equivalents include cash and short-term investments with original maturities of less than three months and are presented at cost, which approximates market value.

### Inventories

Inventories of operating and maintenance supplies and raw materials are valued at the lower of average cost and replacement cost. Work in process and finished goods are valued at the lower of average cost and net realizable value, and include the cost of raw materials, direct labor and manufacturing overhead expenses.

### Property, plant and equipment

Property, plant and equipment are stated at cost. Interest costs are capitalized for major capital projects. For timber limits and timberlands, amortization is calculated using the unit of production method. For all other assets, amortization is calculated using the straight-line method over the estimated useful lives of the assets. Buildings are depreciated up to 40 years and Machinery and equipment up to 20 years. The amortization expense is reported net of the amount of the amortization of deferred credits related to property, plant and equipment. No amortization is recorded on assets under construction.

### Other assets

Other assets are recorded at cost. Expenses and discount related to the issuance of long-term debt are deferred and amortized on a straight-line basis over the term of the related obligation. Goodwill arising from acquisitions completed prior to July 1, 2001, are amortized on a straight-line basis over periods not exceeding 25 years. At each balance sheet date, Domtar assesses whether there has been a permanent impairment in the value of goodwill. This is accomplished mainly by determining whether projected undiscounted future cash flows from operations exceed the net carrying amount of goodwill as of the assessment date.

### Deferred credits

Deferred credits comprise the deferred gain on the contribution of net assets to Norampac Inc. and subsidiaries (Norampac), grants and investment tax credits obtained upon the acquisition of property, plant and equipment. The deferred gain on the contribution of net assets to Norampac, $53 million as at December 31, 2001 (2000 – $58 million), is amortized on a straight-line basis over 15 years. Grants and investment tax credits are amortized on the same basis as the related property, plant and equipment.

### Environmental costs

Environmental expenditures, including site remediation costs, are expensed or capitalized depending upon their future economic benefit. Expenditures that prevent future environmental contamination are capitalized and amortized on a straight-line basis over a 15-year period. Liabilities are not discounted, and are recorded when remediation efforts are likely to occur and the costs can be reasonably estimated.

### Stock-based compensation

Domtar has established stock-based compensation plans and other stock-based payments, described in Note 15. Domtar does not recognize compensation expense when shares or share options are issued to plan participants, except for the Deferred Share Unit Plan which is accounted for using the intrinsic value method. Any consideration paid by plan participants on the exercise of share options or the purchase of shares is credited to stated capital.

### Derivative financial instruments

Domtar manages its foreign exchange exposure on anticipated net cash inflows in U.S. dollars through the use of options and forward contracts. Resulting gains and losses are recognized when realized, and are included in "Net sales." The cost of options is amortized over the hedging period and is also included in "Net sales."

Domtar manages its exposure to price risk associated with sales of kraft linerboard and purchases of old corrugated containers through the use of cash-settled swap contracts. Resulting gains and losses are recognized when realized and are included in "Net sales" or "Cost of sales."

Domtar manages its exposure to interest rates on its long-term debt through the use of interest rate swaps. Amounts accounted for under interest rate swap agreements are recognized as adjustments to interest expense.

### Pension and other employee future benefits

Net periodic benefit costs for pension and other employee future benefits are determined by independent actuaries. Benefits include defined benefit pension plans, life insurance and health care programs. Domtar amortizes past service costs and cumulative unrecognized net actuarial gains and losses, in excess of 10% of the greater of the projected benefit obligation or the market-related value of plan assets, over the average remaining service period of the active employee group covered by the plans. The expected return on pension plan assets is based on a market-related value determined by using a five-year moving average for equity securities held, and by valuing other asset classes at their fair value.

# 2.
## Accounting Changes

### 2001
#### Earnings per share
Effective January 1, 2001, Domtar has adopted the Canadian Institute of Chartered Accountants (CICA) recommendations relating to the calculation of earnings per share. The recommendations require the application of the treasury stock method to calculate the dilutive effect of stock options and other dilutive securities. In accordance with the transitional provisions of the recommendations, Domtar has restated the diluted earnings per share for prior years. The adoption of the recommendations had the effect of increasing previously disclosed diluted earnings per share by $0.01 for each of the years ended December 31, 2000 and 1999.

### 2000
#### Income taxes
Effective January 1, 2000, Domtar has adopted the CICA recommendations relating to the accounting for income taxes. The recommendations require the use of the asset and liability method of accounting for income taxes. Domtar has applied the recommendations on a retroactive basis without restating prior years. The cumulative effect of the adoption of the recommendations, a charge of $112 million, has been reflected as an adjustment to opening retained earnings for the year ended December 31, 2000.

#### Employee future benefits
Effective January 1, 2000, Domtar has adopted the CICA recommendations relating to the accounting for employee future benefits. The recommendations outline guidance for the accounting for pensions, post-retirement and post-employment benefit costs. Domtar has applied the recommendations on a retroactive basis without restating prior years. The cumulative effect of the adoption of the recommendations, a charge of $61 million ($39 million net of income taxes), has been reflected as an adjustment to opening retained earnings for the year ended December 31, 2000.

### Impact of accounting pronouncements not yet implemented
#### Stock-based compensation and other stock-based payments
In December 2001, the CICA issued new recommendations relating to stock-based compensation and other stock-based payments. Effective for the fiscal year beginning January 1, 2002, the recommendations require the use of a fair-value based approach of accounting for certain specified stock-based awards. For all other employee stock-based awards, the recommendations do not require that a fair value-based approach be used. The recommendations also address the accounting for stock appreciation rights and awards to be settled in cash, other financial assets and equity. Domtar does not expect the recommendations to have an initial material impact on its financial statements upon adoption.

#### Foreign currency translation
In November 2001, the CICA issued amended recommendations relating to the accounting for foreign currency translation to eliminate the requirement to defer and amortize unrealized translation gains and losses on foreign currency denominated monetary items that have a fixed or ascertainable life extending beyond the end of the fiscal year following the current reporting period. The amendment is effective for the fiscal year beginning January 1, 2002 and must be applied retroactively with restatement of prior years. Had Domtar applied the new method in 2001, it would have recognized an additional foreign currency loss of $15 million ($10 million net of income taxes) and retained earnings as at December 31, 2001 would have been reduced by $31 million.

#### Goodwill and intangible assets
In July 2001, the CICA issued new recommendations relating to the accounting for goodwill and other intangible assets that require intangible assets with an indefinite life and goodwill arising from acquisitions completed after June 30, 2001 to no longer be amortized. Effective January 1, 2002, all goodwill and indefinite life intangible assets will no longer be amortized, and will be tested annually for impairment by comparing the fair value of the assets with their carrying amount. Intangible assets with a definite life will continue to be amortized over their useful life. Amortization expense related to goodwill was $4 million for the year ended December 31, 2001. Domtar will test its goodwill for impairment upon adoption of the new recommendations and, if impairment is indicated, will record such impairment as a restatement to opening 2002 retained earnings.

# 3.
## United States Dollar Amounts

The consolidated financial statements are expressed in Canadian dollars and, solely for the convenience of the reader, the 2001 financial statements and the tables of certain related notes have been translated into U.S. dollars at the year-end rate of CAN$1.5926 = US$1.00. This translation should not be construed as an application of the recommendations relating to the accounting for foreign currency translation, but rather as supplemental information for the reader.

# 4.
## Business Acquisitions

### 2001

### Four U.S. mills and related assets from Georgia-Pacific

On August 7, 2001, Domtar acquired from Georgia-Pacific Corporation four integrated pulp and paper mills and related assets located in Ashdown, Arkansas, Nekoosa and Port Edwards, Wisconsin and Woodland, Maine, for a consideration in cash of $2,531 million (US$1,650 million) and $38 million of transaction related costs. The acquisition has been accounted for using the purchase method and, accordingly, the purchase price was allocated to the assets acquired and liabilities assumed based on their estimated fair value as of the acquisition date. The results of operations of these acquired mills were included in the consolidated financial statements from the date of acquisition. Details of the acquisition at the effective date are as follows:

| | $ |
|---|---|
| **Net assets acquired at assigned values:** | |
| Current assets | 388 |
| Current liabilities | (124) |
| Operating working capital | 264 |
| Property, plant and equipment | 2,461 |
| Other assets | 2 |
| Other liabilities | (158) |
| | 2,569 |
| **Consideration:** | |
| Cash, including transaction related costs | 2,569 |

The allocation of the purchase price has not been completed as of year end, and the assigned values may be modified once the ongoing study on the integration and restructuring of assets acquired is completed and a formal plan is approved.

Assuming an effective date of January 1, 2000 for the acquisition of the four integrated pulp and paper mills and related assets, and considering the financing of the acquisition by the issuance of the term loan and the 7.875% notes mentioned in Note 13 and the common share issuance done in October 2001 mentioned in Note 15, the unaudited pro forma consolidated financial information would have been as follows for the years ended December 31:

| | 2001 | 2000 |
|---|---|---|
| | $ | $ |
| | unaudited | unaudited |
| Net sales | 5,451 | 5,426 |
| Net earnings | 163 | 387 |
| Net earnings per common share | | |
| Basic | 0.71 | 1.68 |
| Diluted | 0.71 | 1.68 |

### Other acquisitions

In 2001, Norampac (a 50-50 joint venture with Cascades Inc.) acquired businesses for a total cash consideration of $93 million (the Corporation's proportionate share being $46.5 million).

December 31, 2001 (In millions of Canadian dollars, unless otherwise noted)

## 4. Business Acquisitions (continued)

### 2000

**Ris Paper**

On July 31, 2000, Domtar acquired all of the issued and outstanding shares of Ris Paper Company, Inc. (Ris Paper), a privately held paper distribution company in the United States. The acquisition has been accounted for using the purchase method. Ris Paper's results of operations have been included in the consolidated financial statements from the effective date of acquisition. Details of the acquisition at the effective date are as follows:

| | $ |
|---|---|
| **Net assets acquired at assigned values:** | |
| Operating working capital, including cash of $1 | 125 |
| Long-term debt | (102) |
| Other assets and liabilities | 8 |
| | 31 |
| **Consideration:** | |
| Cash, including transaction related costs | 7 |
| 1,971,861 common shares | 24 |
| | 31 |

Assuming an effective date of January 1, 1999 for the Ris Paper acquisition, the unaudited pro forma consolidated net sales of Domtar would have been $4,015 million and $3,830 million for the years ended December 31, 2000 and 1999, respectively. The impact on net earnings and earnings per share would not have been significant.

**Other acquisitions**

In 2000, Domtar acquired businesses for a total cash consideration of $16 million (considering the Corporation's proportionate interest in Norampac) and the assumption of $3 million of long-term debt.

### 1999

**Norkraft Quévillon**

On December 16, 1999, Domtar acquired all of the issued and outstanding shares of Norkraft Quévillon Inc. held by a non-controlling shareholder for a cash consideration of $9 million.

## 5. Financing Expenses

| | 2001 | 2001 | 2000 | 1999 |
|---|---|---|---|---|
| | US$ (Note 3) | $ | $ | $ |
| Interest on long-term debt | 89 | 142 | 97 | 104 |
| Amortization of deferred debt issue expenses, deferred exchange losses and other | 11 | 18 | 7 | 8 |
| | 100 | 160 | 104 | 112 |
| Less: Income from short-term investments | 2 | 3 | – | 1 |
| Capitalized interest | 3 | 5 | 3 | – |
| | 95 | 152 | 101 | 111 |

Cash payments for interest, net of interest income and amounts capitalized, totaled $128 million in 2001 (2000 – $94 million; 1999 – $104 million).

# 6.
## Income Taxes

| Income tax expense | 2001 | 2001 | 2000 | 1999 |
|---|---|---|---|---|
| | US$ (Note 3) | $ | $ | $ |
| Combined basic Canadian federal and provincial tax rate (statutory income tax rate) | 39.8% | 39.8% | 40.7% | 41.9% |
| Income tax expense based on statutory income tax rate | 41 | 66 | 155 | 114 |
| Large corporation tax | 4 | 7 | 7 | 7 |
| Manufacturing and processing credit | (2) | (4) | (25) | (17) |
| Foreign rate differential | (8) | (12) | – | – |
| Non-deductible amortization | – | – | 1 | 10 |
| Impact of reduction in income tax rate on future income taxes | (24) | (39) | (16) | – |
| Reduction of valuation allowance | – | – | (14) | – |
| Other | (2) | (4) | (3) | (3) |
| Income tax expense | 9 | 14 | 105 | 111 |
| Income tax expense (recovery): | | | | |
| Current | 25 | 40 | 30 | 12 |
| Future | (16) | (26) | 75 | 99 |
| | 9 | 14 | 105 | 111 |

Cash payments for income taxes in 2001 amounted to $23 million (2000–$36 million; 1999–$33 million).

| Components of future income tax expense (recovery) | 2001 | 2001 | 2000 | 1999 |
|---|---|---|---|---|
| | US$ (Note 3) | $ | $ | $ |
| Utilization (creation) of non-capital losses | (11) | (18) | 59 | 18 |
| Difference between income tax allowance and accounting amortization | 21 | 34 | 30 | 53 |
| Expenses deducted for income tax purposes and capitalized in the financial statements (reversal) | (4) | (6) | 19 | 27 |
| Reduction in income tax rate | (24) | (39) | (16) | – |
| Reduction of valuation allowance | – | – | (14) | – |
| Other | 2 | 3 | (3) | 1 |
| Future income tax expense (recovery) | (16) | (26) | 75 | 99 |

Amounts presented for 1999 are based on previous accounting recommendations (Note 2).

December 31, 2001 (In millions of Canadian dollars, unless otherwise noted)

# 6.
## Income Taxes (continued)

| Future income tax assets and liabilities | 2001 | 2001 | 2000 |
|---|---|---|---|
| | US$ (Note 3) | $ | $ |
| **Future income tax assets:** | | | |
| Non-capital loss carryforwards | 27 | 44 | 45 |
| Investment tax credits and other deferred credits | 23 | 37 | 40 |
| Disallowed provisions | 70 | 111 | 37 |
| Employee future benefits | 6 | 9 | 11 |
| Other | 6 | 9 | 9 |
| | 132 | 210 | 142 |
| **Future income tax liabilities:** | | | |
| Property, plant and equipment | (448) | (713) | (668) |
| Other assets | (5) | (9) | (13) |
| | (453) | (722) | (681) |
| Total net future income tax liability | (321) | (512) | (539) |
| Net current future income tax asset | 18 | 29 | 30 |
| Net non-current future income tax liability | (339) | (541) | (569) |
| | (321) | (512) | (539) |

# 7.
## Earnings Per Share

| The following table provides the reconciliation between basic and diluted earnings per share: | 2001 | 2001 | 2000 | 1999 |
|---|---|---|---|---|
| | US$ (Note 3) | $ | $ | $ |
| Net earnings | 95 | 152 | 275 | 163 |
| Dividend requirements of preferred shares | 1 | 2 | 3 | 3 |
| Net earnings applicable to common shares | 94 | 150 | 272 | 160 |
| Weighted average number of common shares outstanding (millions) | 191.2 | 191.2 | 182.9 | 183.9 |
| Effect of dilutive stock options (millions) | 0.7 | 0.7 | 0.7 | 0.7 |
| Weighted average number of diluted common shares outstanding (millions) | 191.9 | 191.9 | 183.6 | 184.6 |
| Basic earnings per share | 0.49 | 0.78 | 1.49 | 0.87 |
| Diluted earnings per share | 0.49 | 0.78 | 1.48 | 0.87 |

# 8.
## Receivables

### Allowance for doubtful accounts
Receivables include an allowance for doubtful accounts of $19 million (2000 – $18 million).

### U.S. accounts receivable
In December 2001, Domtar entered into an agreement to transfer a senior beneficial interest in $357 million (US$224 million) of trade accounts receivable to a third party for a cash consideration of $190 million and for a subordinate interest in those receivables amounting to $165 million, net of a $2 million charge recognized on the transfer, which is included in "Receivables". The book value of the retained interests approximates fair value. Domtar has retained responsibility for servicing the accounts receivable transferred. No servicing asset or liability has been recorded, since the fees received for servicing the accounts receivable approximate the related value of the services rendered. Domtar will establish a revolving agreement in early 2002.

### Canadian accounts receivable
In December 2000, Domtar entered into a revolving agreement to sell eligible Canadian accounts receivable. The agreement, which expires in December 2003, allows for sales of eligible accounts receivable up to a maximum of $75 million. At December 31, 2001, Domtar had sold, on a limited recourse basis, accounts receivable amounting to $48 million (2000 – $60 million). The expense recognized on the sales of receivables under this program amounted to $2 million in 2001 (2000 – nil). Domtar has retained responsibility for servicing the accounts receivable sold. No servicing asset or liability has been recorded, since the fees received for servicing the accounts receivable approximate the related value of the services rendered.

The cash received from the transfer and sales of accounts receivable, $178 million (2000 – $60 million), was included in the Consolidated Statement of Cash Flows as a source of cash from accounts receivable.

# 9.
## Inventories

| | 2001 | 2001 | 2000 |
|---|---|---|---|
| | US$ (Note 3) | $ | $ |
| Work in process and finished goods | 270 | 430 | 311 |
| Raw materials | 104 | 166 | 131 |
| Operating and maintenance supplies | 115 | 183 | 104 |
| | 489 | 779 | 546 |

# 10.
## Property, Plant and Equipment

| | 2001 | 2001 | | | 2000 | | |
|---|---|---|---|---|---|---|---|
| | Net Carrying Amount US$ (Note 3) | Cost $ | Accumulated Amortization $ | Net Carrying Amount $ | Cost $ | Accumulated Amortization $ | Net Carrying Amount $ |
| Machinery and equipment | 2,925 | 6,294 | 1,636 | 4,658 | 3,670 | 1,392 | 2,278 |
| Buildings | 410 | 989 | 335 | 654 | 759 | 295 | 464 |
| Timber limits and land | 113 | 195 | 15 | 180 | 188 | 17 | 171 |
| Assets under construction | 68 | 108 | – | 108 | 80 | – | 80 |
| | 3,516 | 7,586 | 1,986 | 5,600 | 4,697 | 1,704 | 2,993 |

December 31, 2001 (In millions of Canadian dollars, unless otherwise noted)

## 11. Other Assets

| | 2001 | 2001 | 2000 |
|---|---|---|---|
| | US$ (Note 3) | $ | $ |
| Goodwill | 46 | 74 | 74 |
| Accrued benefit asset – defined benefit pension plans | 55 | 88 | 75 |
| Exchange losses on translation of long-term debt | 29 | 47 | 32 |
| Long-term debt issuance expenses | 26 | 41 | 15 |
| Discount on long-term debt | 8 | 12 | – |
| Other | 11 | 17 | 20 |
| | 175 | 279 | 216 |

## 12. Trade and Other Payables

| | 2001 | 2001 | 2000 |
|---|---|---|---|
| | US$ (Note 3) | $ | $ |
| Trade accounts payable | 240 | 382 | 272 |
| Accrued vacation pay | 47 | 75 | 48 |
| Accrued salaries, wages and benefits | 43 | 68 | 55 |
| Accrued interest | 27 | 42 | 30 |
| Payables on capital projects | 16 | 26 | 19 |
| Accrued benefit liability – pension plans and other employee future benefits | 7 | 11 | – |
| Provision for site remediation costs | 5 | 8 | 12 |
| Other | 67 | 107 | 96 |
| | 452 | 719 | 532 |

# 13.
## Long-Term Debt

| | Maturity | 2001 | 2001 | 2000 |
|---|---|---|---|---|
| | | US$ (Note 3) | $ | $ |
| **The Corporation and its subsidiaries** | | | | |
| Unsecured debentures and notes | | | | |
| 12% Notes (2000 – US$11) | 2001 | – | – | 17 |
| 10.35% Debentures | 2006 | – | – | 49 |
| 8.75% Notes (2001 and 2000 – US$150) | 2006 | 150 | 239 | 225 |
| 10% Debentures | 2011 | 51 | 82 | 82 |
| 7.875% Notes (2001 – US$600) | 2011 | 600 | 955 | – |
| 9.5% Debentures (2001 and 2000 – US$125) | 2016 | 125 | 199 | 188 |
| 10.85% Debentures | 2017 | 47 | 75 | 75 |
| Unsecured term loan (2001 – US$730) | 2006 | 730 | 1,163 | – |
| Unsecured revolving credit facility | 2006 | – | – | 195 |
| Other | | 6 | 9 | 6 |
| | | 1,709 | 2,722 | 837 |
| **Norampac** | | | | |
| Unsecured notes | | | | |
| 9.5% Notes (2001 and 2000 – US$75) | 2008 | 75 | 119 | 113 |
| 9.375% Notes | 2008 | 31 | 50 | 50 |
| Reducing revolving credit facility secured (2001 – € 4; 2000 – € 5) | 2003 | 4 | 6 | 7 |
| Capital lease obligations (2001 – € 4) | | 4 | 6 | – |
| Other | | 4 | 7 | 7 |
| | | 118 | 188 | 177 |
| | | 1,827 | 2,910 | 1,014 |
| Less: Due within one year | | 24 | 38 | 41 |
| | | 1,803 | 2,872 | 973 |

As at December 31, 2001, principal long-term debt repayments, including capital lease obligations, in each of the next five years amounted to:

| 2002 | 2003 | 2004 | 2005 | 2006 |
|---|---|---|---|---|
| $ | $ | $ | $ | $ |
| 38 | 82 | 75 | 75 | 1,148 |

# 13.

## Long-Term Debt (continued)

### The Corporation and its subsidiaries

*Unsecured debentures and notes*

The 10% and 10.85% debentures each have purchase fund requirements, whereby the Corporation has undertaken to make all reasonable efforts to purchase quarterly, for cancellation, a portion of the aggregate principal amount of the debentures at prices not exceeding par.

On September 1, 2001, the Corporation redeemed the $49 million 10.35% debentures at a redemption price of 101.2% of the principal amount.

On October 16, 2001, the Corporation issued $937 million (US$600 million) 7.875% notes due in 2011 at an issue price of $925 million (US$592 million).

*Bank facilities*

On August 7, 2001, the Corporation borrowed $1,380 million under two 12-month bridge loans ($460 million under an equity bridge loan and US$600 million under a bond bridge loan) and $1,534 million (US$1,000 million) under a five-year term loan facility denominated in U.S. dollars. In addition, this bank facility included a new US$500 million unsecured revolving credit facility expiring in 2006. This facility replaced the $500 million unsecured revolving credit facility entered into on November 30, 2000. These transactions were entered into in conjunction with the initial financing of the acquisition of the four integrated pulp and paper mills described in Note 4.

In October 2001, the Corporation used the proceeds from the issuance of common shares described in Note 15 and from the issuance of the 7.875% notes described above to repay the balances of the bridge loans and to reduce the term loan.

The Corporation has concluded interest rate swaps, described in Note 16, as hedges of a portion of the interest on the 7.875% notes payable.

The term loan bears interest based on the U.S. dollar LIBOR rate or U.S. prime rate, plus a margin that varies with Domtar's credit rating and requires amortization of 25% of the balance currently outstanding from July 31, 2002 through April 30, 2006.

Borrowings under the unsecured revolving credit facility bear interest at a rate based on Canadian dollar bankers' acceptances or U.S. dollar LIBOR rate or prime rate, plus a margin that varies with Domtar's credit rating.

During 2001, the interest rates on outstanding borrowings under the bank facilities ranged from 3.16% to 7.5% (2000 – from 6.24% to 7.75%).

As at December 31, 2001, $15 million (2000 – $17 million) of borrowings under the unsecured revolving credit facility were outstanding in the form of overdraft and included in "Bank indebtedness." In addition, as at December 31, 2001, the Corporation had outstanding letters of credit pursuant to this bank credit for an amount of $11 million (2000 – $8 million).

The indentures or agreements under which certain of the Corporation's debt was issued contain covenants, including a limitation on the amount of dividends on its shares that the Corporation may pay, on the amount of shares that it may repurchase for cancellation and on the amount of term loan it may incur. The bank facilities contain restrictive covenants. The US$500 million unsecured revolving credit facility also requires commitment fees, in accordance with standard banking practices.

### Norampac

As at December 31, 2001, Norampac had a credit agreement with a syndicate of banks with respect to a reducing revolving credit facility of $39 million (2000 – $57 million) and a revolving credit facility of $75 million (2000 – $75 million) (together the "Bank Credit"), drawings under the latter being included in "Other." Borrowings under the Bank Credit are not guaranteed by the Corporation, and are secured by all the receivables and inventories of Norampac and by the property, plant and equipment of Norampac having a net carrying amount of $127 million (2000 – $129 million). Borrowings under the Bank Credit bear interest at floating rates plus a margin based on Norampac's consolidated leverage ratio. As at December 31, 2001, the interest rates on outstanding borrowings under the reducing revolving credit facility and the revolving credit facility were 3.81% and 4.38% (2000 – 5.42% and 4.85%), respectively.

# 14.
## Commitments and Contingencies

### Environment
Domtar is subject to environmental laws and regulations enacted by federal, provincial, state and local authorities. In 2001, Domtar made environmental capital expenditures of $16 million (2000 – $7 million; 1999 – $12 million), mostly for the improvement of air emissions. At this time, Domtar cannot estimate the additional capital expenditures that may be required. However, management expects that if any expenditures are required, they will not have a material adverse effect on Domtar's financial position, earnings or cash flows.

Domtar is continuing to take remedial action under its Care and Control Program at a number of former operating sites, especially in the wood preserving sector, due to possible soil, sediment or groundwater contamination. The investigation and remediation process is lengthy and subject to the uncertainties of changes in legal requirements, the development of technological applications, and the allocation of liability among potentially responsible parties.

As at December 31, 2001, Domtar had a $47 million (2000 – $41 million) provision to cover site remediation costs known and determinable, of which the long-term portion of $39 million (2000 – $29 million) was included in "Other liabilities and deferred credits." The portion of this provision's fluctuation recognized in earnings in 2001 was $2 million (2000 – nil; 1999 – $3 million), and was included in "Selling, general and administrative" expenses. However, additional costs, not yet identified, could be incurred for site remediation. Based on policies and procedures in place to monitor environmental exposure, management believes that any additional site remediation costs will not have a material adverse effect on Domtar's financial position, earnings or cash flows.

### Contingencies
Domtar is party to environmental and other claims and lawsuits that are being contested. Management believes that the resolution of these claims and lawsuits will not have a material adverse effect on Domtar's financial position, earnings or cash flows.

### E.B. Eddy Acquisition
On July 31, 1998, Domtar acquired all of the issued and outstanding shares of E.B. Eddy Limited and E.B. Eddy Paper, Inc. (E.B. Eddy), an integrated producer of specialty paper and wood products. The purchase agreement includes a purchase price adjustment whereby, in the event of the acquisition by a third party of more than 50% of the shares of the Corporation in specified circumstances, the Corporation may have to pay up to a maximum of $120 million, an amount which will gradually decline over a 25-year period.

### Lease commitments
The Corporation and its subsidiaries have entered into operating leases for property and equipment. Minimum future rental payments under these operating leases, determined as at December 31, 2001, were as follows:

| 2002 | 2003 | 2004 | 2005 | 2006 | Thereafter | Total |
|---|---|---|---|---|---|---|
| $ | $ | $ | $ | $ | $ | $ |
| 30 | 25 | 19 | 14 | 11 | 23 | 122 |

Total rental expense amounted to $32 million in 2001 (2000 – $23 million; 1999 – $17 million).

Norampac has entered into operating leases for property and equipment. Domtar's proportionate share of Norampac's minimum future rental payments under these operating leases, determined as at December 31, 2001, were as follows:

| 2002 | 2003 | 2004 | 2005 | 2006 | Thereafter | Total |
|---|---|---|---|---|---|---|
| $ | $ | $ | $ | $ | $ | $ |
| 7 | 6 | 5 | 3 | 3 | 5 | 29 |

Domtar's proportionate share of Norampac's total rental expense amounted to $6 million in 2001 (2000 – $5 million; 1999 – $2 million).

December 31, 2001 (In millions of Canadian dollars, unless otherwise noted)

# 15.
## Stated Capital

### Preferred shares

The outstanding preferred shares at December 31 were as follows:

| | 2001 | | 2001 | | 2000 |
|---|---|---|---|---|---|
| | US$ (Note 3) | Number of shares | $ | Number of shares | $ |
| Serial preferred shares | | | | | |
| Series A | 1 | 69,576 | 2 | 69,576 | 2 |
| Series B | 29 | 1,830,000 | 46 | 1,950,000 | 49 |
| | 30 | | 48 | | 51 |

The authorized serial preferred shares consist of preferred shares issuable in an unlimited number of series, ranking equal with respect to the payment of dividends and the distribution of assets.

The Series A Preferred shares are non-voting and redeemable at the Corporation's option at $25.00 per share since April 1, 1994. These shares carry a cumulative cash dividend per share of $2.25 per annum.

The Series B Preferred shares are non-voting and redeemable at the Corporation's option at $25.00 per share. These shares carry a cumulative cash dividend equivalent to 72% of the bank prime rate.

The Corporation has undertaken to make all reasonable efforts to purchase quarterly, for cancellation, 1% of the number of Series A and Series B Preferred shares outstanding on April 2, 1992 at prices not exceeding $25.00 per share. In connection therewith, Preferred shares purchased for cancellation were as follows:

| | 2001 | | 2000 | | 1999 | |
|---|---|---|---|---|---|---|
| | Number of shares | Average price per share $ | Number of shares | Average price per share $ | Number of shares | Average price per share $ |
| Series B | 120,000 | 23.06 | 120,000 | 20.62 | 120,000 | 19.98 |

On May 1, 1999, all issued and outstanding Series F Preferred shares were redeemed by the Corporation at a cash price per share of $25.00.

**Common shares**

The Corporation is authorized to issue an unlimited number of common shares. The changes in the number of outstanding common shares and their aggregate stated value from January 1, 1999 to December 31, 2001 were as follows:

| | 2001 | | 2001 | | 2000 | | 1999 |
|---|---|---|---|---|---|---|---|
| | US$ (Note 3) | Number of shares | $ | Number of shares | $ | Number of shares | $ |
| Balance at beginning of year | 769 | 180,394,416 | 1,224 | 184,139,827 | 1,234 | 183,429,542 | 1,226 |
| Shares issued | | | | | | | |
| Shares issued for cash, net of expenses | 313 | 45,209,790 | 499 | – | – | – | – |
| Acquisition of Ris Paper | – | – | – | 1,971,861 | 24 | – | – |
| Stock option and share purchase plans | 6 | 881,573 | 10 | 623,128 | 8 | 1,079,185 | 11 |
| Shares purchased for cancellation | (1) | (283,400) | (2) | (6,340,400) | (42) | (368,900) | (3) |
| Balance at end of year | 1,087 | 226,202,379 | 1,731 | 180,394,416 | 1,224 | 184,139,827 | 1,234 |
| Book value per common share at end of year | 6.70 | | 10.66 | | 9.87 | | 9.44 |

On October 5, 2001, the Corporation issued 40,209,790 common shares at $11.44 per share for a total gross consideration of $460 million or $444 million net of underwriting discount, other offering expenses, and related income taxes of $7 million. On October 25, 2001, the Corporation issued an additional 5,000,000 common shares, in conjunction with the exercise of the over-allotment option granted by the Corporation to the underwriters, for gross proceeds of $57 million or $55 million net of underwriting discount and related income taxes of $1 million.

During 2001, the Corporation purchased for cancellation 283,400 common shares (2000 – 6,340,400 shares; 1999 – 368,900 shares) at an average price per share of $12.22 (2000 – $13.54; 1999 – $15.93) under a Normal Course Issuer Bid. The excess of the purchase price over the average stated capital of the shares has been charged to retained earnings.

Book value per common share is the sum of the stated value of common shares, retained earnings and accumulated foreign currency translation adjustments divided by the number of common shares outstanding at year end.

**Executive stock option and share purchase plan**

Under the Executive Stock Option and Share Purchase Plan (the "Plan"), options and rights may be granted to selected eligible employees. Options are granted at a price equal to the market value on the day immediately preceding the date the options were granted and generally expire ten years after the date of the grant. Normally, one-fourth of the options may be exercised at each anniversary date of the grant. Rights permit eligible employees to purchase shares at 90% of the quoted market value on the day immediately preceding the date the rights were granted, and provide for a one-for-four bonus share to be issued on the third anniversary date of the grant.

December 31, 2001 (In millions of Canadian dollars, unless otherwise noted)

# 15.
## Stated Capital (continued)

During the second quarter of 2001, all of the 900,000 performance options granted in March 1997 became void as a result of not meeting the specified conditions to exercise the options based on the market value of the Corporation's common shares. A new performance option program was then approved, and 1,050,000 stock options were granted to the senior management team. Pursuant to this grant, and except in certain specified circumstances, there is no pro rata or early vesting prior to January 1, 2004, at which time the options become fully vested if the holder of the options is an employee of Domtar at that time. After vesting, the options may not be exercised unless both of the following two conditions have been met: 1) at any time between January 1, 2001 and December 31, 2003, the weighted average trading price of the Corporation's common shares during 20 consecutive trading days on the Toronto Stock Exchange has reached or exceeded: $16.70, $18.51 or $20.32, whereupon 25%, 50% or 100%, respectively, of the options granted become exercisable; and 2) the appreciation in the market value of the Corporation's common shares between January 1, 2001 and the exercise date is equal to or exceeds the increase in the Standard & Poor's U.S. Paper & Forest Products index during the same period. The new performance options have a term of seven years and expire in June 2008.

The fair value of options granted during the years ended December 31, 2001, 2000 and 1999 was estimated using the Black-Scholes option-pricing model with the following weighted average assumptions:

| | 2001 | 2000 | 1999 |
|---|---|---|---|
| Risk-free interest rate | 5.7% | 6.0% | 5.3% |
| Annual dividends per share (in dollars) | $0.14 | $0.14 | $0.14 |
| Expected lives (years) | 6 | 6 | 6 |
| Volatility | 34.5% | 33.5% | 30.0% |
| Weighted average fair value of options granted during the year (in dollars per option) | $3.29 | $6.52 | $3.21 |

Changes in the number of options outstanding were as follows:

| | 2001 | | 2000 | | 1999 | |
|---|---|---|---|---|---|---|
| | Number | Weighted average exercise price $ | Number | Weighted average exercise price $ | Number | Weighted average exercise price $ |
| Outstanding at beginning of year | 3,602,023 | 11.76 | 3,058,465 | 10.59 | 3,097,348 | 10.69 |
| Granted | 2,266,950 | 12.86 | 747,000 | 16.08 | 739,690 | 9.48 |
| Exercised | 227,769 | 9.67 | 125,091 | 9.43 | 566,467 | 9.52 |
| Cancelled | 1,067,971 | 12.29 | 78,351 | 10.94 | 212,106 | 10.96 |
| Outstanding at end of year | 4,573,233 | 12.29 | 3,602,023 | 11.76 | 3,058,465 | 10.59 |
| Options exercisable at end of year | 1,508,596 | | 1,118,197 | | 874,304 | |

The following table summarizes information about options outstanding and exercisable at December 31, 2001:

| | Options outstanding | | | Options exercisable | |
|---|---|---|---|---|---|
| Range of exercise prices | Number | Weighted average contractual life | Weighted average exercise price $ | Number | Weighted average exercise price $ |
| \$6.38 – \$9.25 | 425,066 | 4.2 | 8.59 | 425,066 | 8.59 |
| \$9.48 – \$11.00 | 1,113,252 | 6.2 | 10.16 | 751,216 | 10.36 |
| \$11.25 – \$12.75 | 1,132,565 | 8.8 | 12.13 | 165,565 | 12.30 |
| \$13.00 – \$16.40 | 1,902,350 | 7.4 | 14.45 | 166,749 | 16.40 |
| | 4,573,233 | | | 1,508,596 | |

During the year, 294,120 shares were issued pursuant to the exercise of rights and 22,682 bonus shares were issued.

As at December 31, 2001, 10,000,000 common shares (2000 – 10,000,000; 1999 – 10,000,000) were authorized for issuance under the Plan. Since its inception 3,286,894 shares have been issued under this plan.

### Deferred Share Units Plan

Under the Deferred Share Units Plan for outside directors, deferred share units (DSU), equivalent in value to a common share, may be granted to eligible directors. In addition, directors may elect to receive their annual retainer and attendance fees in DSUs. A participant shall receive, not later than the 31st of January following the end of the year during which the participant ceases to be a member of the Board, a lump sum payment in cash equal to the number of DSUs recorded in the participant's account on the termination date multiplied by the termination value of the common shares or, if the participant so elects, a number of common shares to be purchased on the open market equal to the number of DSUs then recorded in the participant's account. Upon payment in full of the DSUs, they shall be cancelled. The total expense recognized in Domtar's results of operations amounted to \$2 million in 2001, representing 100,123 DSUs authorized and issued since the inception of the plan.

### Employee Share Purchase Plans

Under the Employee Share Purchase Plans, all employees are eligible to purchase common shares at a price of 90% of the quoted market value. Common shares are purchased under the plans on monthly investment dates. Shares purchased under the Canadian plan are subject to a mandatory twelve-month holding period. Employees who hold the shares for 18 months following the date of acquisition (U.S. plan) or who hold the shares purchased in any calendar year until June 30 of the following year (Canadian plan) are entitled to receive additional common shares equivalent to 10% of the cost of such shares.
As at December 31, 2001, 3,350,000 common shares (2000 – 3,350,000; 1999 – 3,350,000) were authorized for issuance under the plans. During the year, 337,002 common shares (2000 – 272,036; 1999 – 252,897) were issued under the plans at an average price of \$12.66 (2000 – \$13.22; 1999 – \$11.74) per share. Since their inception, 3,128,066 shares have been issued under these plans.

December 31, 2001 (In millions of Canadian dollars, unless otherwise noted)

# 16.
## Financial Instruments

### Fair value of financial instruments

| | 2001 | | 2001 | | 2000 | |
|---|---|---|---|---|---|---|
| | Fair value US$ (Note 3) | Carrying amount US$ (Note 3) | Fair value $ | Carrying amount $ | Fair value $ | Carrying amount $ |
| Long-term debt | 1,886 | 1,827 | 3,004 | 2,910 | 1,048 | 1,014 |

The fair value of the long-term debt, including the portion due within one year, is principally based on quoted market prices.

Due to their short-term maturity, the carrying amounts of cash and cash equivalents, receivables, bank indebtedness and trade and other payables approximate their fair values.

### Interest rate risk
Domtar's exposure to interest rate risk is as follows:

| | |
|---|---|
| Cash and cash equivalents | Floating rate and non-interest bearing |
| Receivables | Floating rate and non-interest bearing |
| Bank indebtedness | Floating rate and non-interest bearing |
| Trade and other payables | Non-interest bearing |
| Bank credit facility | Floating rate |

The following represents Domtar's carrying amount of long-term debt by date of repayment, based on maturity date or management's expectation to repurchase long-term debt when debentures have purchase fund requirements. Management's expectation reflects prevailing market conditions.

| | | |
|---|---|---|
| Long-term debt | | |
| Maturing in 1 year or less: | 2 | Fixed interest rate |
| Maturing in 1 year or less: | 36 | Variable interest rate |
| Maturing in 2 to 5 years: | 245 | Fixed interest rate |
| Maturing in 2 to 5 years: | 1,135 | Variable interest rate |
| Maturing in 6 to 10 years: | 1,214 | Fixed interest rate |
| Maturing in 6 to 10 years: | 5 | Variable interest rate |
| Maturing in 11 or more years: | 273 | Fixed interest rate |

The Corporation has concluded interest rate swaps for a nominal value of $956 million (US$600 million) ending in October 2006. These swaps are designated as hedges of a portion of the interest on the 7.875% notes payable until the swaps' maturity. Under the terms of these swaps, the Corporation will, on a semi-annual basis, receive an average fixed interest rate of 4.45% on $956 million (US$600 million) until October 2006 and pay 2.48% on $478 million (US$300 million) until October 2002 and 3.16% on $478 million (US$300 million) until October 2003. The interest paid on the two parts after these initial dates until October 2006 will be calculated based on the LIBOR three-month rate. As at December 31, 2001, these interest rate swap contracts had a negative net value of $19 million (US$12 million).

Norampac has an interest rate swap agreement for a nominal value of $5.7 million (US$3.6 million), the Corporation's proportionate share being $2.8 million (US$1.8 million). Under the terms of this swap, maturing in October 2012, Norampac will, on monthly basis, receive interest calculated on the LIBOR one-month rate plus 1.5%, and pay an average fixed rate of 7.25%. Norampac is holding this derivative financial instrument for speculative purposes and, accordingly, the derivative is recorded at its fair value, which was negligible as at December 31, 2001.

### Credit risk

Domtar is exposed to credit risk on the accounts receivable from its customers. In order to reduce this risk, Domtar reviews new customers' credit histories before extending credit and conducts regular reviews of existing customers' credit performance.

Domtar is also exposed to credit risk in the event of non-performance by counterparties to its financial instruments. Domtar minimizes this exposure by entering into contracts with counterparties that are believed to be of high credit quality. Collateral or other security to support financial instruments subject to credit risk is usually not obtained. The credit standing of counterparties is regularly monitored. Domtar believes there are no significant concentrations of credit risk.

### Foreign currency risk

In order to reduce the potential negative effects of a fluctuating Canadian dollar, Domtar has entered into various arrangements to stabilize anticipated future net cash inflows denominated in U.S. dollars.

| | Average exchange rate (CAN$/US$) | | Contractual amounts (In million of U.S. dollars) | |
|---|---|---|---|---|
| | 2001 | 2000 | 2001 | 2000 |
| Forward foreign exchange contracts | | | | |
| 0 to 12 months | 1.46 | 1.45 | 305 | 848 |
| 13 to 24 months | 1.49 | 1.46 | 131 | 265 |
| 25 to 36 months | – | 1.48 | – | 81 |
| Currency options purchased | | | | |
| 0 to 12 months | 1.44 | 1.45 | 376 | 20 |
| 13 to 24 months | 1.43 | 1.43 | 209 | 302 |
| 25 to 36 months | 1.48 | 1.43 | 85 | 209 |
| Currency options sold | | | | |
| 0 to 12 months | 1.53 | 1.60 | 376 | 20 |
| 13 to 24 months | 1.52 | 1.52 | 209 | 302 |
| 25 to 36 months | 1.60 | 1.52 | 85 | 209 |

December 31, 2001 (In millions of Canadian dollars, unless otherwise noted)

# 16.
## Financial Instruments (continued)

Forward foreign exchange contracts are contracts whereby Domtar has the obligation to sell U.S. dollars at a specific rate.

Currency options purchased are contracts whereby Domtar has the right, but not the obligation, to sell U.S. dollars at the strike rate if the U.S. dollar trades below that rate. Currency options sold are contracts whereby Domtar has the obligation to sell U.S. dollars at the strike rate if the U.S. dollar trades above that rate.

The fair value of derivative financial instruments generally reflects the estimated amounts that Domtar would receive or pay to settle the contracts at December 31, 2001 and 2000. As at these dates, the spot exchange rates were $1.59 and $1.50, respectively, and the fair value of the above derivative financial instruments was as follows:

| | 2001 | 2001 | 2000 |
|---|---|---|---|
| | US$ (Note 3) | $ | $ |
| Unrealized loss on forward foreign exchange contracts | (32) | (51) | (51) |
| Unrealized loss on currency options | (28) | (44) | (3) |

As at December 31, 2000, Domtar had a provision of $11 million corresponding to the fair value, at the date of acquisition of E.B. Eddy, of hedging instruments acquired and still outstanding at December 31, 2000. After taking into consideration this provision, the potential net unrealized losses stated above for 2000 were $43 million.

### Price risk

Norampac enters into cash settled swap agreements to manage price risk associated with sales of kraft linerboard and purchases of old corrugated containers. As at December 31, 2001, Norampac had entered into contracts expiring in 2002 and 2003. These derivative agreements fix the sale price for 159,750 tons (2000 – 105,350 tons) of kraft linerboard and fix the purchase price for 16,200 tonnes (2000 – 45,000 tonnes) of old corrugated containers. The fair value of these instruments, as at December 31, 2001, represented a net unrealized gain of $1.7 million (2000 – net unrealized loss of $1 million).

# 17.
## Accumulated Foreign Currency Translation Adjustments

| | 2001 | 2001 | 2000 | 1999 |
|---|---|---|---|---|
| | US$ (Note 3) | $ | $ | $ |
| Balance at beginning of year | (1) | (1) | (1) | 2 |
| Effect of changes in exchange rates during the year: | | | | |
| On the net investment in self-sustaining foreign subsidiaries | 53 | 85 | (1) | (6) |
| On certain long-term debt denominated in foreign currencies designated as a hedge of the net investment in self-sustaining foreign subsidiaries | (51) | (82) | 1 | 3 |
| Balance at end of year | 1 | 2 | (1) | (1) |

# 18.
## Interest in Joint Ventures

The following amounts represent the Corporation's proportionate interest in its joint ventures (Norampac and Anthony-Domtar Inc.):

| | 2001 | 2001 | 2000 |
|---|---|---|---|
| | US$ (Note 3) | $ | $ |
| **Assets** | | | |
| Current assets | 98 | 156 | 157 |
| Long-term assets | 303 | 483 | 396 |
| **Liabilities** | | | |
| Current liabilities | 62 | 98 | 75 |
| Long-term liabilities | 170 | 271 | 250 |

| | 2001 | 2001 | 2000 | 1999 |
|---|---|---|---|---|
| | US$ (Note 3) | $ | $ | $ |
| **Earnings** | | | | |
| Net sales | 340 | 542 | 524 | 453 |
| Operating profit | 51 | 82 | 100 | 59 |
| Financing expenses | 11 | 17 | 18 | 21 |
| Net earnings | 30 | 47 | 56 | 22 |
| **Cash flows** | | | | |
| Cash flows provided from operating activities | 45 | 71 | 111 | 38 |
| Cash flows used for investing activities | (58) | (93) | (50) | (14) |
| Cash flows provided from (used for) financing activities | 6 | 9 | (42) | (24) |

December 31, 2001 (In millions of Canadian dollars, unless otherwise noted)

# 19.
## Pension and Other Employee Future Benefit Plans

### i) Pension plans
### Defined contribution plans
Domtar contributes to several defined contribution, multi-employer and 401(k) plans. The pension expense under these is equal to Domtar's contribution. The 2001 pension expense was $11 million (2000 and 1999 – $4 million).

### Defined benefit plans
Domtar has several defined benefit pension plans covering substantially all employees. These plans are generally contributory in Canada and non-contributory in the United States. The assets of the pension plans are invested primarily in listed common stock and fixed income securities. The pension expense and the obligation related to the defined benefit plans are actuarially determined using management's most probable assumptions.

**Components of net periodic benefit cost for defined benefit plans**

| | 2001 | 2001 | 2000 | 1999 |
|---|---|---|---|---|
| | US$ (Note 3) | $ | $ | $ |
| Service cost for the year | 15 | 24 | 19 | 14 |
| Interest expense | 42 | 67 | 62 | 61 |
| Expected return on plan assets | (48) | (77) | (73) | (66) |
| Recognized actuarial gains | – | – | – | (9) |
| Other | – | 1 | – | 2 |
| Net periodic benefit cost for defined benefit plans | 9 | 15 | 8 | 2 |

Amounts presented for 1999 are based on previous accounting recommendations (Note 2).

Domtar's funding policy is to contribute annually the amount required to provide for benefits earned in the year and to fund past service liabilities over periods not exceeding those permitted by the applicable regulatory authorities. Past service liabilities primarily arise from improvements to plan benefits.

**Change in accrued benefit obligation**

| | 2001 | 2001 | 2000 |
|---|---|---|---|
| | US$ (Note 3) | $ | $ |
| Accrued benefit obligation at beginning of year | 600 | 956 | 868 |
| Service cost for the year | 15 | 24 | 19 |
| Interest expense | 42 | 67 | 62 |
| Plan participants' contributions | 8 | 13 | 13 |
| Acquisitions | 5 | 8 | – |
| Amendments | 1 | 2 | 12 |
| Actuarial losses | 22 | 35 | 36 |
| Benefits paid | (36) | (58) | (56) |
| Effect of foreign currency exchange rate changes | 1 | 1 | – |
| Other | 1 | 1 | 2 |
| Accrued benefit obligation at end of year | 659 | 1,049 | 956 |

**Change in assets of defined benefit plans**

| | 2001 | 2001 | 2000 |
|---|---|---|---|
| | US$ (Note 3) | $ | $ |
| Fair value of defined benefit plan assets at beginning of year | 602 | 958 | 897 |
| Actual return on plan assets | (5) | (8) | 86 |
| Employer contributions | 13 | 20 | 15 |
| Plan participants' contributions | 8 | 13 | 13 |
| Acquisitions | 1 | 2 | – |
| Benefits paid | (36) | (58) | (56) |
| Effect of foreign currency exchange rate changes | – | 1 | – |
| Other | 1 | 2 | 3 |
| Fair value of defined benefit plan assets at end of year | 584 | 930 | 958 |

**Funded status**

| | 2001 | 2001 | 2000 |
|---|---|---|---|
| | US$ (Note 3) | $ | $ |
| Excess (deficiency) of fair value of defined benefit plan assets over accrued benefit obligation at end of year | (75) | (119) | 2 |
| Unrecognized actuarial losses | 94 | 149 | 28 |
| Unrecognized past service costs | 7 | 12 | 12 |
| Net amount recognized | 26 | 42 | 42 |

December 31, 2001 (In millions of Canadian dollars, unless otherwise noted)

# 19.
## Pension and Other Employee Future Benefit Plans (continued)

### Amounts recognized in the Consolidated Balance Sheets

| | 2001 | 2001 | 2000 |
|---|---|---|---|
| | US$ (Note 3) | $ | $ |
| Accrued benefit asset – defined benefit plans | 55 | 88 | 75 |
| Accrued benefit liability – defined benefit plans | (29) | (46) | (33) |
| Net amount recognized | 26 | 42 | 42 |

### Weighted-average assumptions

| | 2001 | 2000 | 1999 |
|---|---|---|---|
| Discount rate | 6.7% | 7.0% | 8.5% |
| Expected return on plan assets | 8.2% | 8.2% | 8.5% |
| Rate of compensation increase | 3.9% | 3.5% | 3.2% |

As at December 31, 2001, the accrued benefit obligation and the fair value of defined benefit plan assets for the pension plans with an accrued benefit obligation in excess of fair value plan assets were $936 million and $814 million (2000 – $116 million and $72 million), respectively.

**ii) Other employee future benefit plans**
The post-retirement and post-employment plans are unfunded. Only certain long-term disability plans, which were settled during the year, were funded.

### Components of net periodic benefit cost for other employee future benefit plans

| | 2001 | 2001 | 2000 |
|---|---|---|---|
| | US$ (Note 3) | $ | $ |
| Service cost for the year | 2 | 3 | 4 |
| Interest expense | 4 | 6 | 5 |
| Actuarial losses | 1 | 1 | – |
| Settlement loss | 1 | 2 | – |
| Net periodic benefit cost for other employee future benefit plans | 8 | 12 | 9 |

Based on previous accounting recommendations (Note 2), the post-retirement benefit expense recognized in 1999 earnings was equal to the payments for the actual costs incurred, being $3 million.

**Change in accrued benefit obligation for other employee future benefit plans**

| | 2001 | 2001 | 2000 |
|---|---|---|---|
| | US$ (Note 3) | $ | $ |
| Accrued benefit obligation at beginning of year | 61 | 98 | 80 |
| Service cost for the year | 2 | 3 | 4 |
| Interest expense | 4 | 6 | 5 |
| Actuarial losses | 2 | 4 | 16 |
| Settlement | (4) | (7) | – |
| Acquisitions | 4 | 6 | – |
| Benefits paid | (4) | (7) | (7) |
| Effect of foreign currency exchange rate changes | – | 1 | – |
| Accrued benefit obligation at end of year | 65 | 104 | 98 |

**Change in assets of other employee future benefit plans**

| | 2001 | 2001 | 2000 |
|---|---|---|---|
| | US$ (Note 3) | $ | $ |
| Fair value of assets of other employee future benefit plans at beginning of year | 5 | 9 | 8 |
| Actual return on plan assets | – | – | 1 |
| Employer contributions | 4 | 7 | 7 |
| Benefits paid | (4) | (7) | (7) |
| Settlement | (5) | (9) | – |
| Fair value of assets of other employee future benefit plans at end of year | – | – | 9 |

**Funded status and amount recognized in the Consolidated Balance Sheets**

| | 2001 | 2001 | 2000 |
|---|---|---|---|
| | US$ (Note 3) | $ | $ |
| Excess of accrued benefit obligation over fair value of plan assets at end of year | 65 | 104 | 89 |
| Unrecognized actuarial losses | (12) | (19) | (15) |
| Net amount recognized in the Consolidated Balance Sheets | 53 | 85 | 74 |

In 2001, Domtar settled its long-term disability obligations through the purchase of an insurance contract by which the insurer assumes all of the risks and obligations under the plans, resulting in a settlement loss of $2 million.

December 31, 2001 (In millions of Canadian dollars, unless otherwise noted)

## 19. Pension and Other Employee Future Benefit Plans (continued)

| Weighted-average assumptions | 2001 | 2000 |
|---|---|---|
| Discount rate | 6.7% | 7.1% |
| Rate of compensation increase | 3.7% | 3.5% |

For measurement purposes, 8.6% weighted-average annual rate of increase in the per capita cost of covered health care benefits was assumed for 2002. The rate was assumed to decrease gradually to 4.0% for 2008 and remain at that level thereafter. An increase or decrease of 1% of this rate would have the following impact:

| | Increase of 1% | Decrease of 1% |
|---|---|---|
| | $ | $ |
| Impact on net periodic benefit cost | 1 | (1) |
| Impact on accrued benefit obligation | 7 | (6) |

## 20. Related Party Transactions

Domtar is not aware of having entered into any transaction, other than on normal commercial terms and in the ordinary course of business, with its shareholders or any party related thereto.

## 21. Segmented Disclosures

Domtar operates in the three reportable segments described below. Each reportable segment offers different products and services and requires different technology and marketing strategies. The following summary briefly describes the operations included in each of Domtar's reportable segments:

**Papers** – represents the aggregation of the manufacturing and distribution of business, printing and publishing, and technical and specialty papers, as well as pulp.

**Wood** – includes the harvesting, manufacture and distribution of lumber and wood-based value-added products as well as the management of Domtar's fiber resources.

**Packaging** – comprises the Corporation's 50% ownership interest in Norampac, a company that manufactures and distributes containerboard and corrugated products.

The accounting policies of the reportable segments are the same as those described in the Summary of Significant Accounting Policies. Domtar evaluates performance based on operating profit, which represents sales, reflecting transfer prices between segments at market value, less allocable expenses before financing expenses and income taxes. Segment assets are those directly used in segment operations.

## Segmented data

| | 2001 | 2001 | 2000 | 1999 |
|---|---|---|---|---|
| | US$ (Note 3) | $ | $ | $ |
| **Net sales** | | | | |
| Papers | | | | |
| External customers | 2,151 | 3,425 | 2,598 | 2,095 |
| Wood[(a)] | | | | |
| External customers | 257 | 410 | 476 | 519 |
| Intersegment sales | 51 | 81 | 78 | 73 |
| Packaging | | | | |
| External customers | 340 | 542 | 524 | 453 |
| Intersegment sales | 6 | 9 | 12 | 10 |
| Total for reportable segments | 2,805 | 4,467 | 3,688 | 3,150 |
| Intersegment sales | (57) | (90) | (90) | (83) |
| Consolidated net sales | 2,748 | 4,377 | 3,598 | 3,067 |
| **Amortization** | | | | |
| Papers | 145 | 231 | 178 | 167 |
| Wood | 20 | 32 | 33 | 34 |
| Packaging | 18 | 28 | 26 | 26 |
| Total for reportable segments | 183 | 291 | 237 | 227 |
| Corporate | 2 | 3 | 2 | 2 |
| Consolidated amortization | 185 | 294 | 239 | 229 |
| **Operating profit (loss)** | | | | |
| Papers | 165 | 263 | 408 | 265 |
| Wood[(a)] | (29) | (46) | (33) | 52 |
| Packaging | 51 | 82 | 100 | 59 |
| Total for reportable segments | 187 | 299 | 475 | 376 |
| Corporate[(b)] | 9 | 14 | 1 | 3 |
| Consolidated operating profit | 196 | 313 | 476 | 379 |
| **Segment assets** | | | | |
| Papers | 3,592 | 5,720 | 3,011 | 2,805 |
| Wood | 353 | 563 | 534 | 545 |
| Packaging | 393 | 626 | 553 | 501 |
| Total for reportable segments | 4,338 | 6,909 | 4,098 | 3,851 |
| Corporate | 121 | 193 | 169 | 168 |
| Consolidated assets | 4,459 | 7,102 | 4,267 | 4,019 |

(a) The year ended December 31, 2001 included a $20 million provision for countervailing and antidumping duties on Domtar's exports of softwood lumber to the United States.
(b) The year ended December 31, 2001 included $16 million related to the cashing in of certain insurance policies.

December 31, 2001 (In millions of Canadian dollars, unless otherwise noted)

# 21.
## Segmented Disclosures (continued)

| | 2001 | 2001 | 2000 | 1999 |
|---|---|---|---|---|
| | US$ (Note 3) | $ | $ | $ |
| **Net additions to property, plant and equipment** | | | | |
| Papers | 99 | 158 | 154 | 151 |
| Wood | 48 | 76 | 42 | 34 |
| Packaging | 27 | 44 | 44 | 21 |
| Total for reportable segments | 174 | 278 | 240 | 206 |
| Corporate | 8 | 12 | 6 | 8 |
| Disposals of property, plant and equipment | (3) | (4) | (4) | (13) |
| Consolidated net additions to property, plant and equipment | 179 | 286 | 242 | 201 |
| **Geographic information** | | | | |
| **Net sales**(c & d) | | | | |
| Canada | 779 | 1,241 | 1,364 | 1,079 |
| United States | 1,896 | 3,019 | 2,157 | 1,922 |
| Other foreign countries | 73 | 117 | 77 | 66 |
| | 2,748 | 4,377 | 3,598 | 3,067 |
| **Property, plant, equipment and goodwill** | | | | |
| Canada | 1,853 | 2,951 | 2,914 | 2,912 |
| United States | 1,692 | 2,696 | 134 | 109 |
| Other foreign countries | 17 | 27 | 19 | 20 |
| | 3,562 | 5,674 | 3,067 | 3,041 |

(c) Sales are attributed to countries based on location of external customer.
(d) In 2001, export sales from Canada were $1,635 million (2000 – $1,658 million; 1999 – $1,750 million).

# 22.
## Reconciliation of Canadian and United States Generally Accepted Accounting Principles

The financial statements have been prepared in accordance with Canadian GAAP which, in the case of Domtar, conform in all material respects with U.S. GAAP, except as set forth below.

### (a) Net earnings and balance sheet adjustments

| Net earnings adjustments | 2001 | 2001 | 2000 | 1999 |
|---|---|---|---|---|
| | US$ (Note 3) | $ | $ | $ |
| **Net earnings in accordance with Canadian GAAP** | 95 | 152 | 275 | 163 |
| ***Adjustments with respect to the following items:*** | | | | |
| Net periodic pension benefit cost [1] | (1) | (2) | (6) | (30) |
| Post-retirement and post-employment benefit costs other than pension [2] | 1 | 1 | – | (4) |
| Unrealized exchange gain (loss) on translation of long-term debt [3] | (10) | (15) | (18) | 35 |
| Unrealized gain (loss) on currency hedging contracts [4] | (33) | (52) | (73) | 150 |
| Unrealized gain on commodity hedging contracts [5] | 2 | 3 | – | – |
| Amortization of deferred gain [7] | (3) | (5) | (5) | (5) |
| Acquisition of E.B. Eddy [8] | (7) | (11) | (13) | (16) |
| Formation of Norampac [9] | (1) | (2) | (2) | – |
| Tax effect of the above adjustments | 18 | 28 | 38 | (38) |
| Difference in the determination of income taxes [10] | – | – | – | 1 |
| **Net earnings in accordance with U.S. GAAP** | 61 | 97 | 196 | 256 |
| Dividend requirements of preferred shares | 1 | 2 | 3 | 3 |
| **Net earnings applicable to common shares in accordance with U.S. GAAP** | 60 | 95 | 193 | 253 |
| **Earnings per share in accordance with U.S. GAAP** | | | | |
| Basic | 0.31 | 0.50 | 1.06 | 1.38 |
| Diluted | 0.31 | 0.50 | 1.05 | 1.37 |

| Balance sheet adjustments | 2001 | | 2001 | | 2000 | |
|---|---|---|---|---|---|---|
| | Canadian GAAP | U.S. GAAP | Canadian GAAP | U.S. GAAP | Canadian GAAP | U.S. GAAP |
| | US$ (Note 3) | US$ (Note 3) | $ | $ | $ | $ |
| Property, plant and equipment [8 & 9] | 3,516 | 3,586 | 5,600 | 5,711 | 2,993 | 3,112 |
| Other assets [1,3,5 & 8] | 175 | 169 | 279 | 270 | 216 | 226 |
| Trade and other payables [4] | 452 | 511 | 719 | 814 | 532 | 575 |
| Long-term debt [6] | 1,803 | 1,791 | 2,872 | 2,853 | 973 | 973 |
| Future income taxes [1 to 5, 7 & 8] | 339 | 324 | 541 | 516 | 569 | 572 |
| Other liabilities and deferred credits [1,2,6 & 7] | 256 | 250 | 408 | 398 | 254 | 219 |
| Shareholders' equity [1 to 5 & 7 to 9] | 1,545 | 1,583 | 2,460 | 2,521 | 1,831 | 1,949 |

Amounts presented under both Canadian and U.S. GAAP account for joint ventures using the proportionate consolidation method as explained in (7) below.

# 22.

## Reconciliation of Canadian and United States Generally Accepted Accounting Principles (continued)

**(1) Net periodic pension benefit cost**
On January 1, 2000, Domtar adopted the Canadian accounting recommendations for employee future benefit costs (Note 2). The recommendations essentially harmonize Canadian GAAP with U.S. GAAP and were applied retroactively without restating prior years. Differences between Canadian and U.S. GAAP remain with respect to the amortization of actuarial gains and losses and past service costs arising prior to January 1, 2000. Furthermore, under U.S. GAAP, an additional minimum pension liability is recorded for plans where the accumulated benefit obligation exceeds the plan assets. For these plans, an intangible asset is recorded up to the extent of unrecognized past service costs. The net amount is recorded in "Other comprehensive income," net of applicable income taxes. The concept of additional minimum liability does not exist under Canadian GAAP.

Prior to 2000, Domtar measured its pension benefit obligations, for Canadian GAAP purposes, using a discount rate based on management's best estimate of the long-term rate of return on the pension fund assets. Under U.S. GAAP, the discount rate to be used should reflect the rate at which the pension costs can be effectively settled at the date of the financial statements. The difference in discount rates impacted annual net periodic pension benefit costs prior to 2000.

**(2) Post-retirement and post-employment benefit costs other than pension**
On January 1, 2000, Domtar adopted the Canadian accounting recommendations for employee future benefit costs (Note 2). The recommendations essentially harmonize Canadian GAAP with U.S. GAAP and were applied retroactively without restating prior years. Differences between Canadian and U.S. GAAP remain with respect to the amortization of actuarial gains and losses arising prior to January 1, 2000. Prior to 2000, Domtar accounted for post-retirement and post-employment benefits on a cash basis, except for post-retirement benefits recorded at the date of acquisition of E.B. Eddy. Under U.S. GAAP, post-retirement benefit costs are charged against earnings on an accrual basis.

**(3) Unrealized exchange gain (loss) on translation of long-term debt**
U.S. GAAP requires immediate recognition in earnings of unrealized foreign currency exchange gains and losses on long-term monetary items with a fixed or ascertainable life, whereas Canadian GAAP requires that these unrealized gains and losses be deferred and amortized over the remaining life of the related monetary items.

**(4) Unrealized gain (loss) on currency hedging contracts**
Under Canadian GAAP, gains and losses on currency hedging contracts are included in earnings only at maturity. In connection with the adoption of SFAS 133 and 138 mentioned under (b)(i) below, Domtar has elected not to designate the contracts as hedging instruments for U.S. GAAP reporting purposes. Accordingly, these contracts are marked to market and resulting unrealized gains and losses are recorded to earnings. Prior to January 1, 2001, under U.S. GAAP, these contracts did not qualify as hedging instruments and accordingly were marked to market, and the resulting unrealized gains and losses were recorded to earnings.

**(5) Unrealized gain on commodity hedging contracts**
Under Canadian GAAP, gains and losses on commodity hedging contracts are included in earnings only at maturity. In connection with the adoption of SFAS 133 and 138 mentioned under (b)(i) below, Domtar has not designated these contracts as hedging instruments for U.S. GAAP reporting purposes. Accordingly, these contracts are marked to market and the resulting unrealized gains and losses are recorded to earnings.

**(6) Unrealized loss on interest rate swap contracts**
Under Canadian GAAP, unrealized gains and losses on interest rate swaps designated as hedges are not recognized in the financial statements. Under U.S. GAAP, interest rate swaps ending in October 2006 described in Note 16 are comprised of two components. The first component swaps the right to receive fixed amounts for an obligation to pay variable amounts until October 2006. This is a fair value hedge of designated interest payments. Accordingly, the $19 million (US$12 million) unrealized loss as at December 31, 2001, is recorded under "Other liabilities and deferred credits" with the offsetting amount being recorded as a reduction of "Long-term debt" due to the component's perfect effectiveness. The second component swaps a right to receive variable amounts for an obligation to pay fixed amounts until October 2002 and 2003. This cannot be designated as a hedge of the variable interest paid on the first component and therefore any fluctuations of its fair value are recorded to earnings. As at December 31, 2001, this component had a negligible fair value.

**(7) Amortization of deferred gain**
Interest in joint ventures is accounted for using the proportionate consolidation method for Canadian GAAP. Under U.S. GAAP, joint ventures are accounted for using the equity method. This difference does not affect the reported earnings or shareholders' equity, and no adjustment is required to the consolidated financial statements as a result of information disclosed in Note 18. However, under Canadian GAAP, a portion of the gain on the contribution to Norampac is deferred and amortized. Under U.S. GAAP, this gain was fully recognized upon the formation of Norampac.

**(8) Acquisition of E.B. Eddy**
The E.B. Eddy acquisition has been accounted for under Canadian GAAP, which at the time differed from U.S. GAAP in the accounting for income taxes (see (10) below), pension benefits (see (1) above) and accounting for business integration costs. As at December 31, 2001, under U.S. GAAP, these differences would have increased "Property, plant, and equipment" by $85 million (2000 – $91 million), "Other assets" by $102 million (2000 – $107 million) and "Future income taxes" by $26 million (2000 – $32 million).

**(9) Formation of Norampac**
On January 1, 2000, Domtar adopted the Canadian accounting recommendations for income taxes (Note 2). These recommendations essentially harmonize Canadian and U.S. GAAP and were applied retroactively without restating prior years. Accordingly, certain property, plant and equipment acquired at the formation of Norampac remained recorded at a lower value under Canadian GAAP.

**(10) Difference in the determination of income taxes**
On January 1, 2000, Domtar adopted the Canadian accounting recommendations for income taxes (Note 2). The Canadian accounting recommendations essentially harmonize Canadian GAAP with U.S. GAAP. For Canadian GAAP, the standard was applied retroactively without restating comparative years. Prior to 2000, under Canadian GAAP, Domtar accounted for income taxes using the deferral method. Under U.S. GAAP, income taxes are provided for on the asset and liability method.

**(b) Supplementary disclosures**

(i) *Accounting Change*
Effective January 1, 2001, Domtar adopted SFAS 133 "Accounting for Derivative Instruments and Hedging Activities" and SFAS 138 "Accounting for Certain Derivative Instruments and Certain Hedging Activities." These standards require all derivative financial instruments to be recorded on the balance sheet as assets or liabilities at their fair value. Changes in fair value of derivatives that are not hedges are recognized in the earnings as they arise. If the derivative is a hedge, depending on the nature of the hedge, a change in the fair value of the derivative is either offset in income against the change in the fair value of the hedged asset, liability or firm commitment or is recognized in other comprehensive income until the hedged item is recognized in earnings. In adopting these standards, Domtar incurred a transition adjustment of $1 million resulting from the net unrealized loss on commodity hedging contracts. As these contracts constituted cash flow hedges, this transitional adjustment has been recorded in "Other comprehensive income" and will be transferred to earnings as the contracts mature.

(ii) *Costs of delivery*
Under U.S. GAAP, the costs of delivery are not deducted from net sales as described in Note 1, but instead are included in cost of sales.

(iii) *Defined benefit pension plans*
The projected benefit obligation, accumulated benefit obligation and fair value of plan assets for the pension plans with accumulated benefit obligations in excess of plan assets were $148 million, $134 million and $87 million as at December 31, 2001 and $35 million, $31 million and $5 million as at December 31, 2000, respectively.

(iv) *Stock-based compensation and other stock-based payments*
Under U.S. GAAP, Domtar has elected to continue to measure compensation cost related to awards of stock options using the intrinsic value based method of accounting. In this instance, however, under SFAS 123, Domtar is required to make pro forma disclosures of net earnings, basic earnings per share and diluted earnings per share as if the fair value based method of accounting had been applied. Accordingly, Domtar's net earnings, basic earnings per share and diluted earnings per share for the year ended December 31, 2001 would have been reduced, on a pro forma basis, by $3 million, $0.02 per share and $0.02 per share, respectively (2000 – $2 million, $0.01 per share and $0.01 per share, respectively) (1999 – $1 million, $0.01 per share and $0.01 per share, respectively).

December 31, 2001 (In millions of Canadian dollars, unless otherwise noted)

# 22.
## Reconciliation of Canadian and United States Generally Accepted Accounting Principles (continued)

(v) *Comprehensive income and Accumulated other comprehensive income*

| Comprehensive income | 2001 | 2001 | 2000 | 1999 |
|---|---|---|---|---|
| | US$ (Note 3) | $ | $ | $ |
| Net earnings in accordance with U.S. GAAP | 61 | 97 | 196 | 256 |
| Additional minimum liability of defined benefit pension plans, net of tax of nil (2000 – $(1) million; 1999 – $1 million) (see (a) (1) above) | (1) | (1) | 1 | (3) |
| Cumulative effect of adopting SFAS 133 and 138 (see (i) above) | (1) | (1) | – | – |
| Foreign currency translation adjustments | 2 | 3 | – | (3) |
| Comprehensive income | 61 | 98 | 197 | 250 |

| Accumulated other comprehensive income | 2001 | 2001 | 2000 | 1999 |
|---|---|---|---|---|
| | US$ (Note 3) | $ | $ | $ |
| Additional minimum liability of defined benefit plans | (5) | (9) | (8) | (9) |
| Unrealized loss on derivative financial instruments | (1) | (1) | – | – |
| Foreign currency translation adjustments | 1 | 2 | (1) | (1) |
| Accumulated other comprehensive income | (5) | (8) | (9) | (10) |

(vi) *Impact of accounting pronouncements not yet implemented*

**Goodwill and other intangible assets**
Concurrently with the issuance by the CICA of Section 3062 described in Note 2, the FASB issued SFAS 142 "Goodwill and Other Intangible Assets." Under U.S. GAAP, as at December 31, 2001, Domtar had goodwill of $102 million arising from the acquisition of E.B. Eddy (see (a) (8) above) in addition to the goodwill under Canadian GAAP. Amortization thereof amounted to $5 million during 2001. Pursuant to SFAS 142, Domtar will test its goodwill for impairment upon adoption and, if impairment is indicated, record such impairment to earnings as required under U.S. GAAP as a cumulative effect of accounting change. Domtar is currently evaluating the effect that the adoption may have on its consolidated results of operations and financial position.

**Asset retirement obligations**
In June 2001, the FASB issued SFAS 143, "Accounting for Asset Retirement Obligations." Domtar must adopt this standard for U.S. GAAP reporting at the beginning of the fiscal year 2003. This standard requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. Domtar is currently assessing the impact that this standard will have on its results of operations and financial position.

**Accounting for the impairment or disposal of long-lived assets**
In August 2001, the FASB issued SFAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which establishes one accounting model to be used for long-lived assets to be disposed of by sale and broadens the presentation of discontinued operations to include more disposal transactions. SFAS 144 supersedes SFAS 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" and certain provisions of Opinion No. 30. Domtar will adopt SFAS 144 on January 1, 2002 for U.S. GAAP purposes. Domtar does not anticipate any immediate financial statement impact with the adoption of this standard.

# 23.
## Comparative Figures

To conform with the basis of presentation adopted in the current year, certain figures previously reported have been reclassified.

# Supplementary Information

December 31, 2001 (In millions of Canadian dollars, unless otherwise noted)

**Selected financial data**

| | 2001 | 2001 | 2000 | 1999 | 1998 | 1997 |
|---|---|---|---|---|---|---|
| | US$(1) | $ | $ | $ | $ | $ |
| **Canadian GAAP** | | | | | | |
| Net sales | 2,748 | 4,377 | 3,598 | 3,067 | 2,348 | 1,938 |
| Operating profit | 196 | 313 | 476 | 379 | 200 | 56 |
| Gain on contribution to Norampac, including amortization of deferred gain | 3 | 5 | 5 | 5 | 5 | 25 |
| Net earnings | 95 | 152 | 275 | 163 | 74 | 25 |
| Total assets | 4,459 | 7,102 | 4,267 | 4,019 | 4,030 | 2,962 |
| Long-term debt | 1,803 | 2,872 | 973 | 1,030 | 1,147 | 852 |
| Total liabilities | 2,914 | 4,642 | 2,436 | 2,228 | 2,342 | 1,661 |
| Shareholders' equity | 1,545 | 2,460 | 1,831 | 1,791 | 1,688 | 1,301 |
| Per common share | | | | | | |
| Net earnings | | | | | | |
| Basic (2) | 0.49 | 0.78 | 1.49 | 0.87 | 0.44 | 0.15 |
| Diluted | 0.49 | 0.78 | 1.48 | 0.87 | 0.43 | 0.15 |

The selected financial data presented above is prepared in accordance with Canadian generally accepted accounting principles (Canadian GAAP). In the case of Domtar, these differ in certain respects from United States generally accepted accounting principles (United States GAAP), as shown in the reconciliation presented in Note 22 to the consolidated financial statements. Earnings and balance sheet data based on United States GAAP follow.

(1) For the convenience of the reader, the 2001 "Selected financial data" have been translated into U.S. dollars at the year-end rate of CAN$1.5926 = US$1.00.
(2) The 1997 results include the after-tax impact of the gain on contribution to Norampac of $0.11 per share.

# Supplementary Information

December 31, 2001 (In millions of Canadian dollars, unless otherwise noted)

**Selected financial data (continued)**

| | 2001 | 2001 | 2000 | 1999 | 1998 | 1997 |
|---|---|---|---|---|---|---|
| | US$(1) | $ | $ | $ | $ | $ |
| **United States GAAP** | | | | | | |
| Net earnings (loss) | 61 | 97 | 196 | 256 | (10) | 23 |
| Total assets | 4,523 | 7,204 | 4,396 | 4,188 | 4,179 | 2,965 |
| Long-term debt | 1,791 | 2,853 | 973 | 1,030 | 1,147 | 852 |
| Total liabilities | 2,940 | 4,683 | 2,447 | 2,352 | 2,538 | 1,627 |
| Shareholders' equity | 1,583 | 2,521 | 1,949 | 1,836 | 1,641 | 1,338 |
| Per common share | | | | | | |
| Net earnings (loss) | | | | | | |
| Basic (2) | 0.31 | 0.50 | 1.06 | 1.38 | (0.08) | 0.13 |
| Diluted | 0.31 | 0.50 | 1.05 | 1.37 | (0.08) | 0.13 |

(1) For the convenience of the reader, the 2001 "Selected financial data" have been translated into U.S. dollars at the year-end rate of CAN$1.5926 = US$1.00.
(2) The 1997 results include the after-tax impact of the gain on contribution to Norampac of $0.11 per share.

## Selected production statistics

(In thousands of tonnes, unless otherwise noted)

| | 2001 | 2000 | 1999 | 1998 | 1997 |
|---|---|---|---|---|---|
| Papers (in thousands of tons) (1) (3) | 1,860 | 1,381 | 1,354 | 1,009 | 780 |
| Pulp (1) (3) | 1,741 | 1,231 | 1,216 | 967 | 797 |
| Lumber (in millions of board feet) (1) | 977 | 1,090 | 1,136 | 869 | 613 |
| Containerboard (2) | 621 | 596 | 584 | 551 | 601 |
| Corrugated containers (in millions of square feet, double-faced equivalent) (2) | 5,674 | 4,844 | 4,621 | 4,457 | 6,318 |

(1) 1998 figures include five months of E.B. Eddy.
(2) 2001, 2000, 1999 and 1998 figures represent 50% of Norampac.
(3) 2001 figures include five months of the four integrated pulp and paper mills acquired from Georgia-Pacific Corporation.

## Quarterly financial information (unaudited)

| | 1st<br>$ | 2nd<br>$ | 3rd<br>$ | 4th<br>$ | Year<br>$ |
|---|---|---|---|---|---|
| **2001** | | | | | |
| Net sales | 954 | 944 | 1,177 | 1,302 | 4,377 |
| Operating profit | 78 | 88 | 83 | 64 | 313 |
| Net earnings | 34 | 76 | 22 | 20 | 152 |
| Cash flows provided from (used for) operating activities | (5) | 143 | 153 | 436 | 727 |
| Net additions to property, plant and equipment | 55 | 57 | 80 | 94 | 286 |
| EBITDA | 138 | 149 | 163 | 157 | 607 |
| Per common share | | | | | |
| Net earnings | | | | | |
| Basic | 0.19 | 0.42 | 0.12 | 0.09 | 0.78 |
| Diluted | 0.18 | 0.41 | 0.12 | 0.09 | 0.78 |
| **2000** | | | | | |
| Net sales | 867 | 832 | 954 | 945 | 3,598 |
| Operating profit | 138 | 120 | 121 | 97 | 476 |
| Net earnings | 72 | 61 | 60 | 82 | 275 |
| Cash flows provided from operating activities | 117 | 143 | 108 | 219 | 587 |
| Net additions to property, plant and equipment | 22 | 73 | 44 | 103 | 242 |
| EBITDA | 197 | 180 | 181 | 157 | 715 |
| Per common share | | | | | |
| Net earnings | | | | | |
| Basic | 0.38 | 0.33 | 0.33 | 0.45 | 1.49 |
| Diluted | 0.38 | 0.33 | 0.33 | 0.44 | 1.48 |

# Historical Summary

(In millions of Canadian dollars, unless otherwise noted)

| | | | 2001 | 2000 |
|---|---|---|---|---|
| | | | $ | $ |
| Operations | Net sales | | 4,377 | 3,598 |
| | Operating expenses | | 4,064 | 3,122 |
| | Operating profit (loss) before unusual items | | 313 | 476 |
| | Unusual items and other expenses | | | |
| | | Unusual items | – | – |
| | | Financing expenses | 152 | 101 |
| | | Premium and write-off on early redemption of long-term debt | – | – |
| | | Gain on contribution to Norampac, including amortization of deferred gain | (5) | (5) |
| | | Income tax expense (recovery) | 14 | 105 |
| | | Non-controlling interest | – | – |
| | Earnings (loss) from continuing operations | | 152 | 275 |
| | Discontinued operations, net of income taxes | | – | – |
| | Net earnings (loss) | | 152 | 275 |
| Financial Position | Assets | Cash, short-term investments and deposits | 36 | 29 |
| | | Other current assets | 1,132 | 999 |
| | | Property, plant and equipment | 5,600 | 2,993 |
| | | Other assets | 334 | 246 |
| | | Total assets | 7,102 | 4,267 |
| | Liabilities and shareholders' equity | | | |
| | | Current liabilities | 821 | 640 |
| | | Long-term debt | 2,872 | 973 |
| | | Future income taxes | 541 | 569 |
| | | Other liabilities and deferred credits and non-controlling interest | 408 | 254 |
| | | Equity element of convertible debentures | – | – |
| | | Preferred shares | 48 | 51 |
| | | Common shareholders' equity | 2,412 | 1,780 |
| | | Total liabilities and shareholders' equity | 7,102 | 4,267 |
| Cash Flows | Operating | Cash flows provided from (used for) operating activities | 727 | 587 |
| | Investing | Net additions to property, plant and equipment | (286) | (242) |
| | | Acquisition of businesses | (2,616) | (22) |
| | | Net consideration received upon contribution to Norampac | – | – |
| | | Net proceeds from business divestitures | – | – |
| | | Other | 1 | (18) |
| | Financing | Dividend payments | (28) | (28) |
| | | Long-term debt and equity financing | 4,289 | – |
| | | Change in bank indebtedness | (2) | (1) |
| | | Change in revolving bank credit | (196) | (163) |
| | | Change in short-term financing | – | – |
| | | Redemption, repayments and other | (1,882) | (87) |
| | Net increase (decrease) in cash and cash equivalents | | 7 | 26 |
| Other Data | Per common share | Earnings (loss) from continuing operations (1) | 0.78 | 1.49 |
| | | Net earnings (loss) (1) | 0.78 | 1.49 |
| | | Cash dividends declared | 0.14 | 0.14 |
| | | Year-end book value | 10.66 | 9.87 |
| | | Market price | | |
| | | Toronto Stock Exchange | | |
| | | High | 16.46 | 22.00 |
| | | Low | 11.00 | 9.90 |
| | Ratios | Return on common shareholders' equity (2) | 8% | 16% |
| | | Net debt-to-total-capitalization ratio (3) | 54:46 | 35:65 |
| | Other statistics | Number of common shareholders | 5,773 | 6,034 |
| | | Number of preferred shareholders | 273 | 301 |
| | | Common shares outstanding (millions) | 226.2 | 180.4 |
| | | Number of employees (4) | 12,500 | 9 155 |
| | | Salaries, wages and benefits (4) | 821 | 611 |

(1) The 1997 results include the after-tax impact of the gain on contribution to Norampac of $0.11 per share. The 1996, 1994, and 1992 results include the after-tax impact of unusual items of $(0.17), $0.11 and $(0.11) per share, respectively.

(2) The 1997 figures exclude a non-recurring $17-million after-tax gain realized on the contribution of Domtar's packaging net assets to Norampac.
The 1996 figures exclude non-recurring items related to the divestitures of the Gypsum and Decorative Panels divisions, a charge related to the refinancing program completed during the year and a charge principally related to asset write-downs.

(3) Ratio of long-term debt and bank indebtedness, including retractable preferred shares for the year 1991, net of cash, short-term investments and short-term deposits held in trust to total capitalization.

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 1999 | 1998 | 1997 | 1996 | 1995 | 1994 | 1993 | 1992 | 1991 |
| $ | $ | $ | $ | $ | $ | $ | $ | $ |
| 3,067 | 2,348 | 1,938 | 1,977 | 2,206 | 1,596 | 1,287 | 1,270 | 1,238 |
| 2,688 | 2,148 | 1,882 | 1,868 | 1,697 | 1,469 | 1,324 | 1,344 | 1,309 |
| 379 | 200 | 56 | 109 | 509 | 127 | (37) | (74) | (71) |
| – | – | – | 35 | – | (27) | – | 19 | – |
| 111 | 91 | 50 | 72 | 123 | 133 | 133 | 107 | 84 |
| – | – | – | 127 | – | – | – | – | – |
| (5) | (5) | (25) | – | – | – | – | – | – |
| 111 | 42 | 8 | (37) | 141 | 10 | (64) | (77) | (53) |
| (1) | (2) | (2) | (1) | 6 | – | – | – | – |
| 163 | 74 | 25 | (87) | 239 | 11 | (106) | (123) | (102) |
| – | – | – | 184 | 65 | 67 | (4) | (36) | (46) |
| 163 | 74 | 25 | 97 | 304 | 78 | (110) | (159) | (148) |
| 3 | 9 | 283 | 44 | 286 | 319 | 115 | 42 | 115 |
| 843 | 788 | 567 | 593 | 710 | 575 | 548 | 557 | 517 |
| 2,969 | 3,000 | 1,954 | 1,982 | 2,076 | 1,809 | 1,898 | 1,955 | 2,038 |
| 204 | 233 | 158 | 90 | 119 | 144 | 130 | 116 | 72 |
| 4,019 | 4,030 | 2,962 | 2,709 | 3,191 | 2,847 | 2,691 | 2,670 | 2,742 |
| 615 | 694 | 408 | 408 | 416 | 367 | 338 | 465 | 308 |
| 1,030 | 1,147 | 852 | 623 | 1,082 | 1,220 | 1,204 | 976 | 1,246 |
| 376 | 269 | 212 | 210 | 240 | 99 | 66 | 118 | 209 |
| 207 | 232 | 189 | 156 | 175 | 183 | 179 | 182 | 180 |
| – | – | – | – | 99 | 93 | 88 | – | – |
| 54 | 87 | 100 | 103 | 216 | 219 | 222 | 225 | 81 |
| 1,737 | 1,601 | 1,201 | 1,209 | 963 | 666 | 594 | 704 | 718 |
| 4,019 | 4,030 | 2,962 | 2,709 | 3,191 | 2,847 | 2,691 | 2,670 | 2,742 |
| 326 | 248 | 125 | 172 | 520 | 166 | 14 | (86) | (18) |
| (201) | (205) | (130) | (351) | (367) | (226) | (94) | (61) | (87) |
| (9) | (456) | – | – | (88) | – | – | – | – |
| – | – | 285 | – | – | – | – | – | – |
| – | – | – | 604 | – | 297 | 28 | – | 8 |
| 23 | (2) | (16) | (19) | 239 | (235) | (5) | (2) | (2) |
| (28) | (25) | (23) | (17) | (5) | (3) | (3) | (7) | (12) |
| 5 | 676 | – | 360 | 4 | 3 | 365 | 350 | 99 |
| 17 | (4) | 15 | (12) | 10 | 16 | (6) | 4 | (10) |
| 198 | 3 | – | – | (89) | (21) | (25) | (194) | 219 |
| – | – | – | – | – | – | – | – | (69) |
| (337) | (509) | (17) | (979) | (31) | (16) | (195) | (86) | (15) |
| (6) | (274) | 239 | (242) | 193 | (19) | 79 | (82) | 113 |
| 0.87 | 0.44 | 0.15 | (0.69) | 1.80 | 0.02 | (0.88) | (1.06) | (1.20) |
| 0.87 | 0.44 | 0.15 | 0.68 | 2.32 | 0.55 | (0.91) | (1.36) | (1.69) |
| 0.14 | 0.14 | 0.14 | 0.14 | – | – | – | – | – |
| 9.44 | 8.73 | 8.03 | 8.04 | 7.56 | 5.23 | 4.69 | 5.57 | 7.12 |
| 18.75 | 12.70 | 13.50 | 12.70 | 14.75 | 10.13 | 9.25 | 8.38 | 10.00 |
| 8.60 | 6.80 | 8.85 | 9.00 | 9.25 | 6.50 | 4.88 | 4.25 | 7.00 |
| 10% | 5% | 1% | 2% | 37% | 12% | (17)% | (23)% | (21)% |
| 37:63 | 41:59 | 32:68 | 31:69 | 39:61 | 48:52 | 55:45 | 54:46 | 59:41 |
| 6,477 | 7,076 | 7,254 | 8,732 | 9,347 | 10,303 | 10,868 | 11,284 | 11,673 |
| 351 | 390 | 418 | 485 | 555 | 624 | 704 | 806 | 2,021 |
| 184.1 | 183.4 | 149.5 | 150.4 | 127.8 | 127.4 | 127.1 | 126.2 | 100.9 |
| 8,232 | 7,946 | 7,300 | 7,574 | 9,503 | 8,985 | 9,821 | 10,270 | 11,145 |
| 544 | 414 | 461 | 462 | 550 | 551 | 562 | 564 | 585 |

(4) All data subsequent to 1997 exclude Norampac. All data prior to 1998 include 100% of Domtar's packaging division, although it was contributed to Norampac on December 30, 1997. The 1998 data for salaries, wages and benefits includes only five months of E.B. Eddy whereas the data for number of employees includes all employees of E.B. Eddy as at December 31, 1998. The 2000 data for salaries, wages and benefits includes only five months of Ris Paper whereas the data for number of employees includes all employees of Ris Paper as at December 31, 2000. The 2001 data for salaries, wages and benefits includes only five months of the four integrated pulp and paper mills acquired from Georgia–Pacific Corporation whereas the data for number of employees includes all employees of the four integrated pulp and paper mills acquired from Georgia–Pacific Corporation as at December 31, 2001.

# Statement of Corporate Governance

Companies listed with the Toronto Stock Exchange (TSE) have to disclose, on an annual basis, their approach to corporate governance and conformity of their practices with the *Guidelines for Improved Corporate Governance* ("Guidelines") issued by the TSE. These guidelines deal, among other things, with the responsibilities of directors, the constitution of the Board and committees of the Board, and Board practices.

Domtar's corporate governance guidelines have been adopted by the Board of Directors in keeping with the Guidelines and with similar systems introduced by public companies.

**Mandate of the Board**
According to the *Canada Business Corporations Act*, the Corporation's governing statute, the business and affairs of the Corporation are managed under the supervision of its Board of Directors. There is no specific mandate for the Board since it has plenary power. The Board determines, among others, the management philosophy, assesses management's execution and reviews the results obtained. Its duties include approval of strategic plans, review of corporate risks identified by management and of the Corporation's practices and policies for dealing with these risks, management succession planning, and assessment of the integrity of the Corporation's internal controls and information systems.

**Composition of the Board**
The Board of Directors is of the view that its directors are unrelated directors, except for Mr. Claude Fontaine who is a senior partner of a law firm which provides legal services to the Corporation on a regular basis; Mr. Harry E. Gould whose company is an important customer of the Corporation; and Mr. Raymond Royer, President and Chief Executive Officer of the Corporation.

Domtar does not have a "significant shareholder" as defined in the Guidelines to mean a shareholder with the ability to exercise a majority of the votes for the election of the Board of Directors. Caisse de dépôt et placement du Québec ("Caisse"), which holds 14.96% of the Corporation's common shares, has disclosed in certain of its public filings that it is a party to an agreement with Société générale de financement du Québec ("SGF"), which holds 19.57% of the Corporation's common shares, whereby Caisse and SGF have agreed to vote their shares to obtain proportionate representation on the Corporation's Board of Directors.

**Chairman of the Board separate from management**
The positions of Chairman of the Board and Chief Executive Officer are separate and distinct. Mr. Jacques Girard holds the position of Chairman of the Board since August 1996. Mr. Raymond Royer holds the position of President and Chief Executive Officer since September 1996.

At all meetings of the Board and committees of the Board, the opportunity is provided to meet without any representatives of management being present. During 2001, the Board and Board committees held, in the aggregate, five such *in camera* sessions without any representatives of management being present.

**Committees**
The Board has established the following committees:

**The Executive Committee** is composed of seven (7) directors, four (4) of whom are outside unrelated directors, one (1) is an inside related director and two (2) are inside unrelated directors. Except as otherwise provided by law and by the administrative resolutions of the Corporation, this Committee may exercise all the powers of the Board of Directors. In practice, however, the Committee acts only with respect to specific matters delegated to it by the Board of Directors, the principal one being the review of projects of a strategic nature. Its approval level is limited to investments not exceeding $10 million. The Committee met eight times in 2001.

**The Nominating and Corporate Governance Committee** is composed of six (6) directors, four (4) of whom are outside unrelated directors and two (2) are inside unrelated directors. The mandate of the Committee is to:
- recommend annually to the Board proposed candidates suitable for election or re-election to the Board;
- review and evaluate periodically the performance and contribution of each director and the effectiveness of the Board as a whole;
- review annually the compensation of the directors in their capacity as directors, and make recommendations to the Board in this respect;
- review periodically the mandates and performance of the committees of the Board and review annually the membership and chairs of the committees, and make recommendations to the Board in this respect;
- monitor the system of corporate governance of the Corporation; and
- advise the Board and the committees of the Board on corporate governance issues.

The Committee met three times in 2001.

**The Human Resources Committee** is composed of seven (7) directors, five (5) of whom are outside unrelated directors and two (2) are inside unrelated directors. The mandate of the Committee is to:

- review the human resources policies of the Corporation;
- approve the engagement and termination, and the promotion and compensation of the members of the Management Committee of the Corporation and the engagement of all officers of the Corporation, except for the Chief Executive Officer and the Chief Operating Officer of the Corporation, in respect of whom the Committee makes recommendations to the Board; and
- review annually, or as needed, the succession planning for the Chief Executive Officer and the Chief Operating Officer, the senior management of the Corporation and their direct reports.

The Committee met six times in 2001.

**The Audit Committee** is composed of five (5) directors, all of whom are outside unrelated directors. The mandate of the Committee is to:

- review, prior to submission to the Board, all financial information and financial statements of the Corporation and the external auditors' report thereon;
- review with the external and internal auditors of the Corporation the arrangements for and scope of each proposed audit of the accounting records and report to the Board any significant reservations the Committee may have or the external or internal auditors may have expressed with respect to such arrangements or scope;
- review periodically with the Corporation's external and internal auditors their respective activities and the nature of their respective recommendations and to report on same at least annually to the Board;
- evaluate the performance of the external auditors, review their fees and make recommendations to the Board in this respect;
- evaluate annually the organization, independence and efficiency of the internal auditors; and
- review periodically the Code of Ethics of the Corporation and its adherence by Management.

The Committee met seven times in 2001.

**The Pension Committee** is composed of six (6) directors, three (3) of whom are outside unrelated directors, one (1) is an inside related director, one (1) is an inside unrelated director and one (1) is an outside related director.
The mandate of the Committee is to:

- approve the investment policy of the pension funds and the benchmarks used to measure the performance of the pension funds;
- recommend annually to the Board, for its approval, the funding policy for the pension funds;
- approve the hiring of the external portfolio managers and their objectives, and evaluate the performance of the external and internal portfolio managers;
- approve assumptions used in valuations of the pension funds and review reports therein; and
- recommend to the Board, for its approval, amendments to the pension plans.

The Committee met twice in 2001.

**The Environment and Health and Safety Committee** is composed of five (5) directors, three (3) of whom are outside unrelated directors, one (1) is an inside related director and one (1) is an outside related director. The mandate of the Committee is to review the policy, management plans, programs, practices and performance of the Corporation in light of applicable environment and health and safety legislative requirements, assess the performance of the Corporation in these areas and make recommendations to the Board.

The Committee met twice in 2001.

### Decisions requiring prior approval by the Board

In general, all matters of management philosophy and strategic direction and all actions proposed to be taken by the Corporation that are not in the ordinary course of its operations require prior approval of the Board or of a Board committee to which approval authority has been delegated by the Board.

### Shareholder communications

The Corporation communicates regularly with its shareholders and the investment community through quarterly reports, annual reports, press releases, periodic meetings and presentations. The Corporation has a shareholder relations process and an investor relations and communication program which enable the Corporation to respond adequately to shareholder questions and concerns and to communicate effectively with its shareholders, stakeholders and the public in general.

### Board's expectations of management

The Board can and does act independently of management. The Board expects management to be responsible for the operation of the business, while respecting authorized financial limits, and adhering to the strategic plan, operational budget and the policies adopted by the Corporation. The Board expects to be advised by management, on a regular basis, as to the results being achieved, and to be presented with alternative plans and strategies to be implemented for approval, in keeping with evolving conditions.

## Board of Directors (As at February 28, 2002)

**Jacques Girard** (1) (3) (4) (6)
Montréal
Chairman of the Board
Domtar Inc.
President and Chief
Executive Officer
Montréal International

**Gilles Blondeau** (1) (3) (4)
Montréal
Vice-Chairman of the Board
Domtar Inc.
Chairman of the Board and
Chief Executive Officer
Optimum Group Inc.

**Paul-Henri Couture** (1) (3)
Montréal
Vice-President
Capital d'Amérique
CDPQ Inc.

**Claude Fontaine, Q.C.** (6)
Montréal
Senior Partner
Ogilvy Renault

**Louis P. Gignac** (1) (3) (5)
Montréal
President and Chief
Executive Officer
Cambior Inc.

**Harry E. Gould Jr.** (5)
New York
Chairman of the Board
President and Chief
Executive Officer
Gould Paper Corporation

**André L'Ecuyer** (1) (3)
Québec
President and Chief
Operating Officer
SGF Rexfor Inc.

**Claude R. Lamoureux** (1) (2) (4) (6)
Toronto
President and Chief
Executive Officer
Ontario Teachers'
Pension Plan Board

**Pierre Lamy** (2) (4) (5)
Montréal
Economic and
Financial Consultant

**Jacques Laurent** (2) (4) (5)
Montréal
Senior Partner
Gowling Lafleur Henderson

**Brian M. Levitt** (3)
Montréal
Co-Chair
Osler, Hoskin & Harcourt

**Louiselle Paquin** (2)
Montréal
Senior Vice-President
Finance
SITQ Immobilier

**Louise Roy** (3)
Montréal
Vice-President, Marketing
and Commercial Services
and Representative in
Canada International Air
Transport Association (IATA)

**Raymond Royer** (1) (5) (6)
Montréal
President and Chief
Executive Officer
Domtar Inc.

**John D. Thompson** (2) (6)
Montréal
Deputy Chairman
of the Board
Montreal Trust

**Edward J. Waters** (4) (6)
New York
Chairman,
President and
Chief Executive Officer
C.I.I.C., Ltd.

Members of the:
(1) Executive Committee
(2) Audit Committee
(3) Human Resources Committee
(4) Nominating and Corporate Governance Committee
(5) Environment and Health and Safety Committee
(6) Pension Committee

## Management Committee

**Raymond Royer**
President and Chief
Executive Officer

**Claude Belley**
Senior Vice-President
Human Resources and
Organizational Development

**Roger H. Brear**
Senior Vice-President
U.S. Pulp and Paper
Manufacturing Group

**Christian Dubé**
Senior Vice-President and
Chief Financial Officer

**Roland Gagnon**
Senior Vice-President
Canadian Pulp and Paper
Manufacturing Group

**George Kobrynsky**
Senior Vice-President
Pulp and Paper Sales,
Marketing and Customer
Relations Group

**Monique Martin**
Senior Vice-President
Wood Products Group

**E. Craig McManus**
Senior Vice-President
Forest Resources Group

**Gilles Pharand**
Senior Vice-President
Corporate Affairs, General
Counsel and Secretary

**C. Lance Skerratt**
Senior Vice-President
Paper Merchants Group

## Shareholder and Investor Information

**Annual Meeting**
The Annual Meeting of Shareholders will be held at 1:30 p.m. on Wednesday, May 1, 2002, at the Mount Royal Centre, Montréal, Qc, Canada

**Annual Information Form**
The Annual Information Form may be obtained by writing to the Secretary of Domtar Inc. at the Head Office.

**Transfer Agents and Registrars**
For Common and Series "A" and "B" Preferred Shares and Debentures: Computershare Trust Company of Canada – Halifax, N.S.; Montréal, Qc; Toronto, Ont.; Calgary, Alta.; Vancouver, B.C.

**For Common Shares only:**
The Bank of New York, New York, N.Y., United States

**U.S. Cash Dividend Plan**
Shareholders wishing to receive dividends in U.S. dollars may obtain detailed information by communicating with Computershare Trust Company of Canada at (514) 982-7555 or 1 800 564-6253

**Stock Exchanges**
Common and Series "A" and "B" Preferred Shares are listed on the Toronto Stock Exchange. The Common Shares are also listed on the New York Stock Exchange. Ticker Symbol: DTC

**Investor Relations**
Christian Dubé
Senior Vice-President and
Chief Financial Officer
Tel.: (514) 848-5511

Jean-Sébastien Vanbrugghe
Manager, Investor Relations
Tel.: (514) 848-5469
Fax: (514) 848-5638
e-mail: ir@domtar.com

**Shareholder Services**
Shareholders having inquiries concerning their shares or debentures, or wishing to obtain information about the Corporation should contact:

**Computershare Trust Company of Canada**
Shareholder Services
1800 McGill College Ave.
Place Montréal Trust
6th Floor
Montréal, Qc, Canada
H3A 3K9
Tel.: (514) 982-7555
or 1 800 564-6253

**Head Office**
**Domtar Inc.**
395 de Maisonneuve Blvd. West
Montréal, Qc, Canada
H3A 1L6
Tel.: (514) 848-5400

## Inquiries

**Domtar Inc.**
William L. George
Vice-President
Communications and
Government Relations Department
Tel.: (514) 848-5213

# Customer Inquiries

## Papers

**Montréal** (Canada and U.S.: Northeast and Midwest)
395 de Maisonneuve Blvd. West
Montréal, Qc, Canada H3A 1L6
Tel.: (800) 267-2040
Fax: (800) 267-4050

**Atlanta** (U.S.: Southeast, Southwest and West)
10 Peachtree Place, N.E.
Atlanta, GA 30309
Tel.: (866) 338-1402
Fax: (866) 338-1404

In order to find the Domtar distributor nearest you, please consult our web site at **www.domtar.com**

## Wood

Forest Resources Group
Tel.: (613) 725-6805

Wood Products Group
Tel.: (514) 848-5010

## Packaging

Norampac Inc.
Tel.: (514) 282-2635

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